



Legislative Audit Division

State of Montana

Report to the Legislature

January 2007

Performance Audit

Conservation Easements

The Department of Administration
The Department of Revenue
The Montana Natural Heritage Program

This report contains findings and recommendations developed as a result of our performance audit of conservation easements in Montana. This audit was conducted in response to passage of Senate Joint Resolution 20 during the 2005 Legislative Session. Findings and recommendations are summarized as follows:

- ▶ Conservation easements cover 1.5 million acres and have become a significant land use issue.
- ▶ Trends show Montana is a national leader in creation of conservation easements.
- ▶ Improvements in compilation and reporting of easement data are necessary.
- ▶ Conservation easements have not adversely affected property taxes, but the long-term fiscal impact is unclear.
- ▶ Over \$100 million in public funding has been dedicated towards conservation easements in Montana.
- ▶ Public oversight of conservation easements should be improved to ensure the public trust is upheld.

A statewide map of Montana Conservation easements is included as Appendix A of this report.

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January 2007

The Legislative Audit Committee
of the Montana State Legislature:

This is our performance audit of conservation easements in Montana. This audit was conducted in response to passage of Senate Joint Resolution (SJR) 20 during the 2005 Legislative Session. SJR 20 requested we address multiple issues relating to conservation easements. This report contains findings and recommendations addressing the location and characteristics of conservation easements, trends in the creation of these easements, procedures for compiling and reporting easement data, property tax implications of easements, direct and indirect public funding for easements, and the need for improvements in public oversight of conservation easements. Written responses from the Department of Administration and the Department of Revenue are included at the end of the report.

We would like to express our gratitude to the many state and federal agency personnel, county officials, representatives of land trusts and other conservation organizations, and private citizens for their cooperation and assistance during the audit.

Respectfully submitted,

/s/ Scott A. Seacat

Scott A. Seacat
Legislative Auditor

Legislative Audit Division

Performance Audit

Conservation Easements

The Department of Administration

The Department of Revenue

The Montana Natural Heritage Program

Members of the audit staff involved in this audit were Angus Maciver,
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Appointed and Administrative Officials

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Montana Natural Heritage Program

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Allan Cox, Systems and Services Manager

Conservation Easements

Conservation easements have grown to over 1.5 million acres in Montana; improvements in data collection methods and public oversight of easements are necessary.

Audit Findings

Analysis of conservation easement data shows there are now [1.5 million acres](#) under easement. At the national level, Montana is a leading state in the creation of conservation easements. Easements provide protection for important habitats, but also bind future generations to current land uses. Given growth in easement acreage, they should be considered a [significant land use issue](#) for policy makers (Chapter II). Despite the growing significance of easements, Montana's approach to compiling and reporting easement data

still relies on voluntary cooperation. [There is no method for accurately and consistently collecting easement data](#) (Chapter III). Getting accurate data on easements is important because of effects relating to local property taxes, public funding and public oversight of easement transactions.

Summary Data for Conservation Easements

<u>Conservation Easement Attribute</u>	<u>Value</u>
Total Acreage	1,573,411
Percentage of State Land Area	1.68 %
Number of Easements	1,250
Average Acreage Per Easement	1,271
Largest Contiguous Easement Acreage	107,123

Source: Compiled by the Legislative Audit Division from agency records.

In relation to property taxes, [easement creation has not resulted in decreased property tax collections](#) through property reclassification. However, easement creation tends to result in maintenance of existing land uses and this indicates [there could be shifts in tax collections over the long-term](#). There is, however, no clear evidence regarding the fiscal impact of these changes (Chapter IV).

Both direct and indirect [public funding is available for conservation easements](#). Direct funding comes through easement acquisitions made by state agencies or counties. Indirect funding comes through the tax system, where individual and corporate tax deductions are available for easements as charitable contributions. Estimates show indirect funding impacts the state's General Fund by between \$1.7 and \$3 million annually. Taken together, direct and indirect [public investment in easements has totaled in excess of \\$100 million](#) cumulatively over the years (Chapter V).

Public investment and the expectation of public benefits associated with easements establish a [duty of public trust](#) for both grantors and grantees. During our review of easement agreements, we identified several [examples where it was unclear whether conservation values and the public trust were being protected](#). These situations highlight the need for public oversight of conservation easement transactions in Montana. The [current approach to easement oversight has relied on voluntary efforts](#) and self-policing by easement grantees (Chapter VI).

Audit Recommendations

Improvements in data collection methods for conservation easements could be made by the Department of Revenue and the Department of Administration. Our recommendations address collection of easement data in counties and integration of this data in the state's Cadastral system (see p.30). To address public oversight of conservation easements, we recommend legislation be enacted to provide for improved oversight mechanisms and ensure the public trust is upheld in easement transactions (see p.65).

Chapter I – Introduction and Background

Introduction

A conservation easement is a voluntary agreement in which a land owner surrenders the right to develop their property to an agency or organization dedicated to maintaining natural habitats, open spaces or traditional agriculture. Conservation easement agreements are generally made between private land owners and government agencies or private land trusts or other conservation organizations. The effects of easements are usually to restrict in perpetuity types of land uses and to encourage preservation of properties in a relatively undeveloped state. As such, the issue of conservation easements cuts across two long-standing and contentious public policy debates in the western United States; private property rights and environmental conservation.

The following sections provide some background information relating to the format and legal basis for conservation easement agreements, including federal and state statutory references. We also include discussion of the roles of various state agencies involved in developing or collecting easement information.

What is a Conservation Easement?

Real property ownership consists of multiple rights, examples of which can include the right to develop or improve your property, or the right to use the land for agriculture or timber extraction. A conservation easement transfers some of these development rights to another party, but the owner retains title to the property and can continue to exercise those rights not included in the agreement. Conservation easement agreements often allow for some level of development or traditional use to continue (such as farming), but prohibit subdivision or development that could harm conservation values.

Conservation easements are generally perpetual in nature. The government agency or land trust party to the agreement holds the rights surrendered by the owner forever and can take court action to enforce these rights. For example, if the agreement prohibits draining of wetlands and the owner engages in these activities, the land trust with which the agreement was signed can sue to prevent or

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remedy the drainage work. Because title to the property does not transfer through the easement, the owner can still sell the land, but the easement terms run with the land and are a permanent encumbrance on future owners.

Definition of Terms

Throughout the report the following terms are used to describe certain features of conservation easement agreements:

Grantor – the land owner (usually a private individual or corporate entity) granting the conservation easement.

Grantee – the government agency (federal, state, tribal, county or city), private land trust or other conservation organization to which a conservation easement is granted.

Permitted Activities – land uses allowed under the easement agreement (can include traditional agriculture uses, timber management, limited residential construction, hunting, fishing and trapping, or other recreational uses).

Restricted/Prohibited Activities – land uses not allowed under the easement agreement (can include subdivision, industrial development or commercial activities, mining, landfill or disposal of toxic waste).

Easement Value – determined by comparing the land value prior to the easement in ‘highest and best use’ and the land value as encumbered by the easement. The difference between the two values is considered the easement value.

Easement Creation/Acquisition – creation and acquisition are used interchangeably to describe the process of either acquiring the easement through direct payment or through the process of grantor donation to grantee.

Conservation Easement/Easement – conservation easements are only one sub-class of easement or servitude on property, but the terms ‘conservation easement’ and ‘easement’ are used interchangeably and refer only to this specific type.

Federal Law Relating to Conservation Easements

Real estate transactions are regulated, primarily, by the states. State law is the main reference for conservation easements, but the federal government has been involved through provisions of the tax code. Since 1976, individuals and corporations have been able to claim

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federal income tax deductions for conservation easements donated as charitable contributions. Federal tax law (specifically United States Code Title 26, Section 170) has been important in driving growth in conservation easements through tax incentives.

Tax deductibility for conservation easements as charitable contributions is based on the potential for an easement to result in reduction in land value. The land owner essentially donates this reduced value to the grantee organization through transfer of partial interests in the property. Donations can also be claimed when an easement is purchased for less than full value, with the remainder value being considered a charitable contribution. Federal law defines a conservation easement deduction as a “qualified conservation contribution,” which must meet the following three conditions.

- 1) The contribution must be a **qualified real property interest** and must be granted in perpetuity. The law also allows deductions for a contribution of the actual property itself.
- 2) The contribution must be made to a **qualified organization**. Tax deductions can only be claimed for contributions to governmental units or recognized and properly organized charitable or non-profit organizations, or private foundations.
- 3) The contribution must be made exclusively for **conservation purposes**. Four types of goals are defined as conservation purposes; preservation of land for use by the public for outdoor recreation/education purposes; protection of relatively natural habitats for wildlife; preservation of open space farm or forest land where such preservation yields benefits either for the scenic enjoyment of the public or as part of a governmental conservation policy; or preservation of historically important landscapes or buildings.

The Code of Federal Regulations, section 1.170A-14, provides detailed rules for defining qualified conservation contributions, including treatment of conservation easements, and includes examples of different circumstances and applicability of laws relating to tax deductions for conservation easements.

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State Law Relating to Conservation Easements

Development of conservation easement policy in Montana can be traced back to the passage of the Open Space Land Act, enacted by the Montana Legislature in 1969. In its original form, the Open Space Land Act established legislative intent with regards to the preservation of open space lands. In 1975, the legislature amended the Open Space Land Act as the Open Space Land and Voluntary Conservation Easement Act. Amendments extended public involvement in preserving open space land, included non-urban land, authorized involvement of private organizations in land preservation, and specifically referenced creation of conservation easements. Statutory references for the amended act are currently found in Title 76 (Land Resources and Use), Chapter 6 (Open Spaces), Montana Code Annotated.

State law contains multiple provisions relating to conservation easements, including the following.

Activities/Developments Prohibited by Easements – conservation easements may prohibit any of the following activities or developments on property; construction, landfill, vegetation removal, timber harvest, excavation or mining, surface uses altering land conditions, acts detrimental to conservation, sub-division, or other acts detrimental to the land in its existing condition.

Qualified Private Organizations – statute allows certain private organizations to acquire conservation easements. Qualified private organizations must be competent to own real property, must hold general federal tax-exempt status under Internal Revenue Code section 501 (c), and their organizational purposes should be designed to further the goals of state open space land laws.

Review and Recording of Easements – organizations acquiring conservation easements are required to submit the easements to county planners for review, but local government comments are only advisory in nature. All conservation easements are to be recorded by the county clerk and recorder. Counties are required to maintain a separate file for conservation easements and report all easements to the Department of Revenue.

Taxation of Property Subject to a Conservation Easement – tax assessments of a property subject to a conservation easement should be based on the restricted purposes for which the property may be used. However, the law also states the minimum assessed value of

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the land may not be less than the actual assessed value in calendar year 1973 and also states a property cannot be reclassified for tax purposes based solely on the creation of an easement.

Entities Involved with Conservation Easements

Several different governmental and non-governmental entities or agencies have responsibilities relating to conservation easements. The respective roles and responsibilities of different governmental and non-governmental entities are described as follows.

Local Government – county clerk and recorder offices are responsible for acceptance and recordation of conservation easement agreements. The agreements must be recorded in the county land records to comply with state law.

Montana Department of Revenue (DOR) – DOR is responsible for receiving reports on conservation easements from county clerk and recorders. The department's Property Assessment Division works with counties to update property ownership records for the purposes of tax assessment. The DOR Business and Income Taxes Division is responsible for general administration of income taxes, including deductibility of easement contributions.

Montana Department of Administration (DofA) – DofA is responsible for maintaining the state's Cadastral database providing public access to land information. The Cadastral system is maintained by the departments Geographic Information Services Bureau in the Information Technology Services Division. DofA also provides support for the Montana Land Information Council, which provides policy guidance on availability of digital land information for the state.

Montana Natural Heritage Program (MNHP) – this program is organizationally attached to The University of Montana, but functions as part of the state's Natural Resources Information System. The primary mission of MNHP is collection and analysis of information on the state's native plant and animal species. As part of its work, the program compiles a statewide land stewardship data set, which includes data on conservation easements.

Montana Department of Fish, Wildlife and Parks (FWP) – FWP holds conservation easements as a grantee. FWP easements are acquired to protect wildlife habitat or provide access to recreational opportunities.

Federal Government – multiple federal government agencies act as easement grantees, the most active being the Fish and Wildlife

Chapter I – Introduction and Background

Service and the Natural Resources Conservation Service. The Internal Revenue Service is responsible for enforcement of laws and regulations relating to tax deductibility of conservation easements.

Land Trusts and Conservation Groups – land trusts and conservation groups frequently act as easement grantees. Land trusts are specifically organized for the purposes of preserving open space lands or traditional agricultural landscapes. Broader-based conservation groups with more diverse aims also act as easement grantees.

Audit Approach Based on Senate Joint Resolution 20

During the 2005 session, the legislature passed Senate Joint Resolution (SJR) 20, which requested a performance audit of conservation easements. SJR 20 requested the Legislative Audit Committee address several issues, summarized as follows:

- ▶ Prioritize a performance audit of the extent of conservation easements and the property tax policy issues associated with conservation easements.
- ▶ Identify the cause of the conflicting information available.
- ▶ Recommend a method for compiling information in a readily available format for use by the legislature and interested parties.
- ▶ Evaluate relevant information to determine trends in conservation easements and development of agricultural lands that would indicate potential for shifts in tax collections.

Audit Scope

SJR 20 provided guidance for determining audit scope and requested an audit addressing the extent of conservation easement holdings in the state, methodologies for compiling and reporting easement data and analysis of easement trends, and how these affect local property tax collections. Unless otherwise stated, our analysis and other audit methodologies address all conservation easements created in Montana since the mid-1970s. Audit work was limited to the agencies and organizations with direct involvement in SJR 20 easement issues (discussed above).

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Audit Objectives

We developed five main audit objectives.

- 1) Determine the extent (location, land area, and ownership characteristics) of conservation easement holdings in Montana and evaluate historical trends in easement creation.
- 2) Assess the effectiveness of current procedures for compiling and reporting data on conservation easement holdings.
- 3) Determine the extent of any impacts on property taxes resulting from conservation easements.
- 4) Determine what level of public funding has been used in the acquisition of conservation easements in Montana.
- 5) Determine whether the terms of conservation easement agreements are being effectively written and enforced to protect the conservation or other values of the land.

Report Organization

Findings and recommendations relating to our audit objectives are addressed in the remaining chapters of this report. Report organization is summarized as follows:

- ▶ Chapters II and III address objective # 1 and discuss analysis of conservation easement data and trends in creation of easements.
- ▶ Chapter IV addresses issues relating to compilation and reporting of easement data included under objective # 2.
- ▶ Chapter V discusses property tax issues relating to easements as addressed in objective # 3.
- ▶ Chapter VI presents information on public funding of conservation easements addressed in objective # 4.
- ▶ Chapter VII addresses the final objective and discusses public oversight of easements.

Chapter II – Statewide Conservation Easement Inventory

Introduction

Our first audit objective related to the extent, location and characteristics of conservation easements. Audit methodologies involved obtaining existing conservation easement data from the Montana Natural Heritage Program (MNHP), performing testing to assess data accuracy, and using data to compile a statewide conservation easement inventory. This chapter discusses procedures used to test data accuracy and presents finding from our analysis of the statewide conservation easement inventory.

Data Validation

Compilation and reporting of conservation easement data in Montana has been conducted for 10 years or more by MNHP. MNHP has collected, analyzed and reported the relevant data on a voluntary basis to assist in an understanding of wildlife habitat stewardship. Compilation of the data currently in existence has relied on the voluntary cooperation of conservation easement grantees. These have included federal and state agencies, land trusts and conservation groups.

Audit Testing to Establish Accuracy of MNHP Data

Analysis of existing easement data involved obtaining a statewide Geographic Information System (GIS) data layer from MNHP showing Montana conservation easements. The primary method for testing data accuracy was review of easement agreements in county land records. The purpose of this review was to establish if MNHP data attributes (location, date, acreage etc.) were consistent with attributes in the conservation easement agreement. Additionally, we independently obtained data from easement grantees. Data obtained from grantees was compared against MNHP data to determine the level of accuracy.

Review Shows MNHP Data is Generally Accurate

Our county review involved analysis of 120 randomly selected conservation easement agreements in 10 counties. Results of the testing showed MNHP data accurately represents the extent of conservation easements recorded in the counties we included in our sample. This was also reflected in a comparison between MNHP and grantee data, which showed easement location and extent

Chapter II – Statewide Conservation Easement Inventory

characteristics in MNHP data were broadly similar to grantee information. Testing of MNHP data shows a degree of accuracy in the range of 90 to 95 percent for the basic attributes included in the data set (location, acreage, and date). Some problems do exist relative to the completeness and accuracy of the data, which are discussed in more detail in Chapter IV. However, for the purposes of aggregate or trend analysis, the MNHP data should be considered accurate and reliable.

Conclusion: Conservation easement data in the Montana Natural Heritage Program land stewardship layer should be considered accurate and reliable for the purposes of aggregate or trend analysis.

Statewide Conservation Easement Inventory

We used the MNHP data to build a statewide conservation easement inventory and analyze multiple attributes relating to the location, extent and other characteristics of easements. The following table summarizes the main attributes discussed in this chapter.

Table 1
Summary Attributes for Montana Conservation Easements
September 2006

<u>Conservation Easement Attribute</u>	<u>Value</u>
Total Acreage	1,573,411
Percentage of State Land Area	1.68 %
Number of Easements	1,250
Average Acreage Per Easement	1,271
Largest Contiguous Easement Acreage	107,123

Source: Compiled by the Legislative Audit Division from Montana National Heritage Program, county and grantee records.

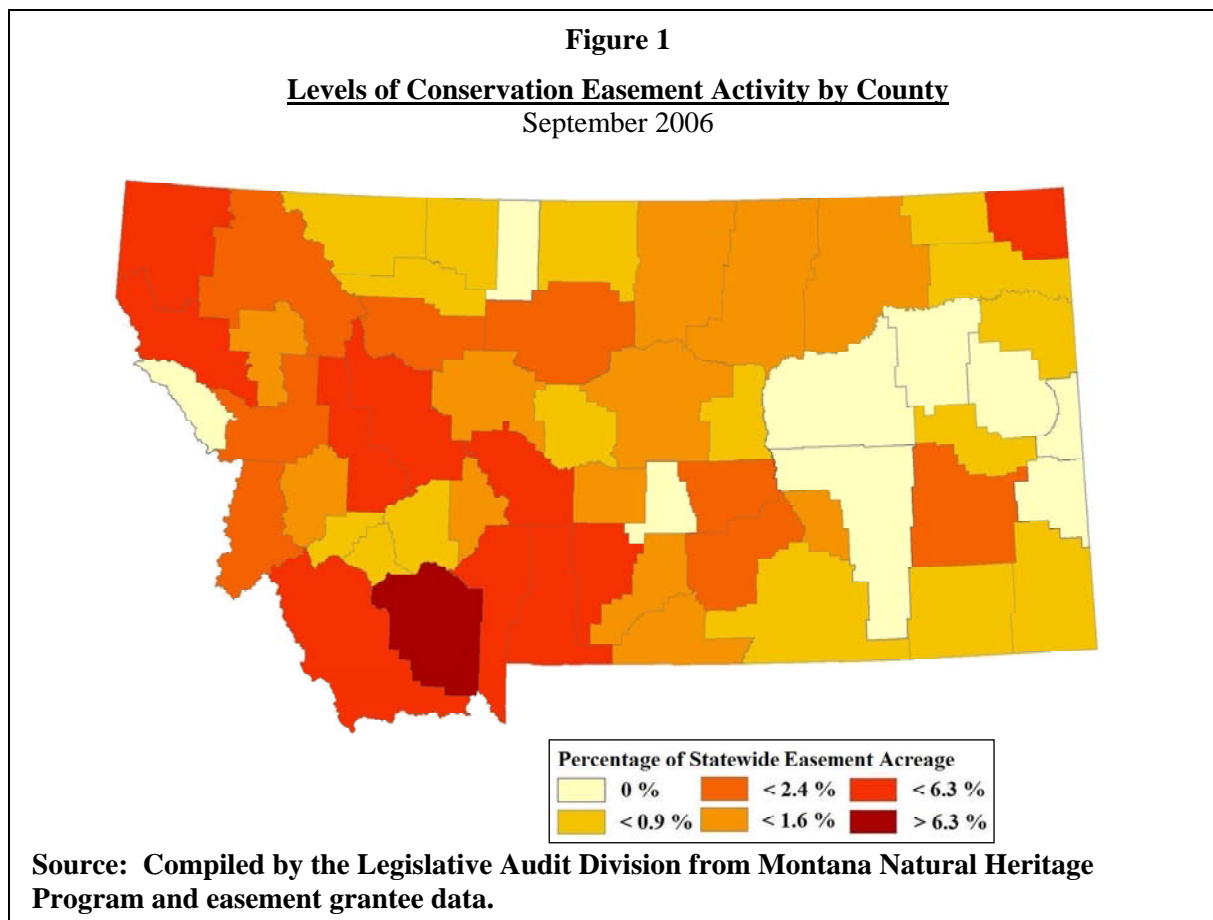
Chapter II – Statewide Conservation Easement Inventory

The inventory contains records for approximately 1,250 conservation easement agreements, which cover around 1.5 million acres of the state. Conservation easements can be found in 48 of Montana's 56 counties, but tend to concentrate in the south and west of the state.

Location and Extent of Easements

We used location data to produce a map showing statewide distribution of conservation easements in Montana. This map is included as Appendix A of this report. The map shows locations of easements and identifies easement grantees as federal agencies, state agencies or private land trusts/conservation organizations. The map shows conservation easement activity has not been uniform across the state. Counties in the south and west of Montana have seen the highest levels of easement activity, both in terms of number of agreements and acreages. Appendix B contains a complete table of county easement acreages for all Montana counties with activity. The figure below shows levels of easement activity for Montana counties based on percentage of statewide conservation easement acreage.

Chapter II – Statewide Conservation Easement Inventory



Although the majority of Montana counties have some portion of their land mass covered by conservation easements, the top 10 counties account for roughly 60 percent of the total. Madison County has the largest acreage under easement at approximately 200,000 acres, representing around 13 percent of statewide acreage and nearly 9 percent of the county land mass. Although counties in the east and north of the state have fewer easements, the average acreage tends to be larger. This is due primarily to patterns of land ownership in areas where large acreage ranch and farm holdings predominate.

Easement Grantee Characteristics

Review of MNHP data showed approximately 15 agencies or organizations have significant conservation easement holdings in Montana. We contacted these grantees directly to obtain information

Chapter II – Statewide Conservation Easement Inventory

on their easement holdings. The following table shows total acreages reported by grantees as of September 2006.

Table 2
Grantee Conservation Easement Acreages
September 2006

<u>Easement Grantee –Agency or Organization</u>	<u>Total Acreage *</u>
Montana Land Reliance	626,463
Montana Department of Fish, Wildlife and Parks	377,747
The Nature Conservancy	241,320
United States Fish and Wildlife Service	193,701
United States Natural Resource Conservation Service	72,516
Rocky Mountain Elk Foundation	31,553
Gallatin Valley Land Trust	24,464
Five Valleys Land Trust	22,467
Ducks Unlimited	17,209
United States Forest Service	7,905
Flathead Land Trust	7,393
Prickly Pear Land Trust	1,160
Bitterroot Land Trust	895
Save Open Space	193
The Vital Ground Foundation	80

*Acreage Values as supplied by grantees. Does not equal statewide total acreage reported by Montana Natural Heritage Program.

Source: Compiled by the Legislative Audit Division from conservation easement grantee records.

Montana Land Reliance is the state's most active grantee and also one of the nation's largest land trusts. Montana Land Reliance has over 600,000 acres under easement, representing around 40 percent of the state total. The Montana Department of Fish, Wildlife and Parks holds around 380,000 acres under easement, representing 24 percent of the state total. The third largest easement holder is The Nature Conservancy, a national conservation group which holds around 240,000 acres or 15 percent of the state total. The remaining

Chapter II – Statewide Conservation Easement Inventory

grantees shown in the table are federal agencies, smaller local land trusts and conservation groups.

Land Ownership Characteristics

Land ownership characteristics of conservation easement properties can be determined through analysis of attributes contained in the Cadastral system. Cadastral contains multiple attribute fields indicating the ownership and uses of property. Analysis of land ownership characteristics for easement properties showed nearly 99 percent of the properties are privately owned and only small percentages are in public ownership. We also used Cadastral data to determine whether property owners are Montana residents or reside in other states. These ownership characteristics are summarized in the following table.

Table 3

Selected Ownership Characteristics for Conservation Easement Properties

<u>Ownership Attribute</u>	<u>Percentage of All Easement Properties</u>
Private Land	98.8 %
Federal or Tribal Government	0.74 %
State Government	0.4 %
Local Government	0.04 %
Montana Residents	74%
Resident in Other States	26%

Source: Compiled by the Legislative Audit Division from Montana Natural Heritage Program and Cadastral records.

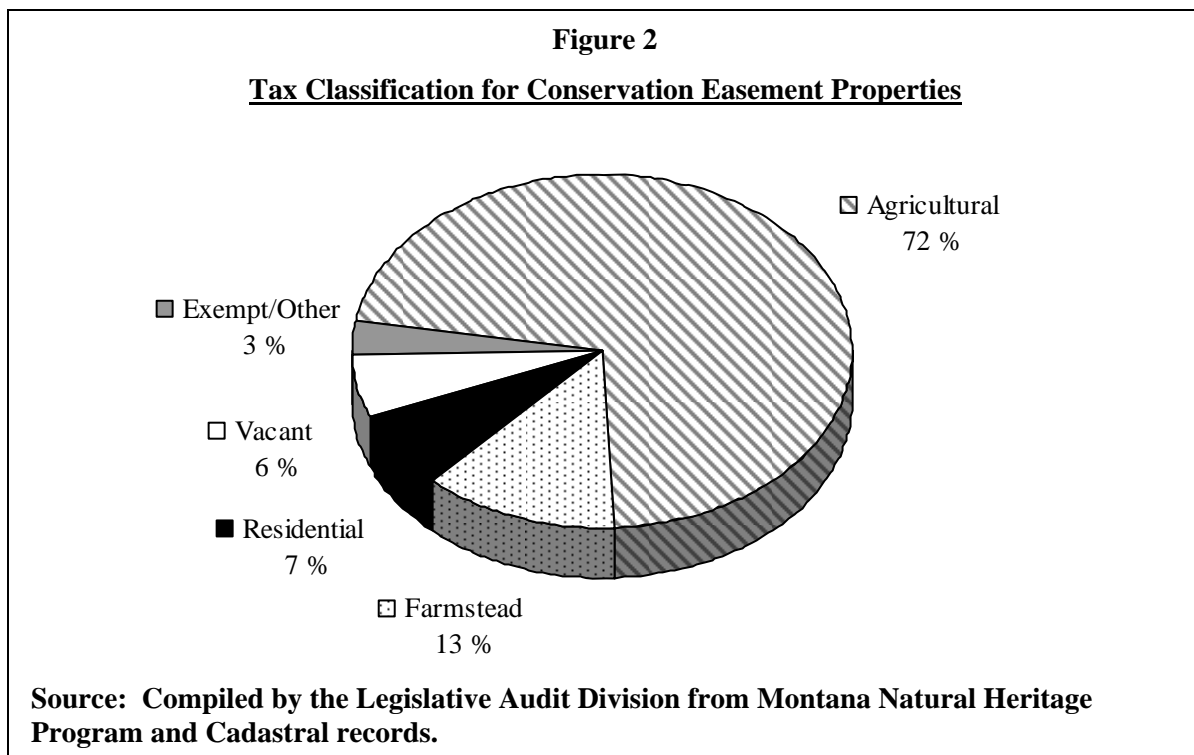
To determine state residency status of property owners, we used zip code attributes from the Cadastral mailing address field as an indicator of probable residency. This approach may over-estimate

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Montana resident grantees, but it represents the best information available. As shown, around three quarters of conservation easements are on properties owned by Montana residents.

Land Use Characteristics

Cadastral also contains attributes showing land use types (the Department of Revenue maintains classifications for all properties in the state according to their use). The following figure illustrates the proportions of different property tax classifications for conservation easement properties.



The majority of property covered by conservation easements is classified as agricultural for tax purposes. This is also true for the acreages involved; nearly 85 percent of conservation easement acreage is currently classified for agricultural use. This is a function of both property use and the fact that most easement properties have sufficient acreage to qualify for agricultural classification. Twenty percent of easement property parcels are classified as either residential or farmstead and have constructed dwellings of some

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kind. In relation to the actual easement agreements, our analysis shows roughly 40 percent of easements cover lands already containing dwellings of some sort.

Wildlife Habitats Protected by Easements

One of the primary purposes of creating conservation easements is protecting habitat important to plant and animal species. Our analysis addressed several aspects of habitat protection in relation to easements. Data for protected wildlife habitat and water courses is presented in the following table.

Table 4	
<u>Wildlife and Other Habitat Protected by Conservation Easement</u>	
<u>Species and Habitat Type</u>	<u>Acreage Under Easement</u>
Elk Winter Range	641,797
Elk Calving Range	31,611
Elk Migration Routes	2,410
Antelope Winter Range	46,279
Mountain Goat Range	22,810
Moose Winter Range	274,053
Bighorn Sheep Range	59,249
Pheasant Habitat	94,008
Wild Turkey Habitat	205,094
<u>Rivers & Water Bodies</u>	<u>Protected by Easement</u>
Streams and Rivers	4,389 miles
Open Water Bodies / Wetlands *	120 square miles

*Average for water bodies and wetlands includes surface areas for lakes and other water bodies adjacent to and offered some degree of protection by conservation easements.

Source: Compiled by the Legislative Audit Division from Montana Natural Heritage Program, Department of Fish, Wildlife and Parks, and United States Geological Survey records.

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Conservation easements currently protect habitat for important game animals including elk, moose and bighorn sheep. These population distributions were sourced from the Department of Fish, Wildlife and Parks. Hydrographic data was sourced from the United States Geological Survey national hydrographic data sets and show conservation easements protect over 4,000 miles of streams and rivers and approximately 120 square miles of open water bodies.

We also conducted a land cover analysis for easement properties showing vegetation types. This information is included as Appendix C of this report.

Conservation Easements as a Significant Land Use Issue

Data presented in this chapter underlines the significance of conservation easements as a land use issue. The total extent and statewide distribution of easement properties indicates they should be considered an important issue for policymakers at different levels of government. Easements now cover around 1.5 million acres and can be found in most Montana counties. Easements are created primarily on private property usually classified as agricultural. Most easement agreements prevent significant land use changes and will have the effect of preserving traditional landscapes.

Easement Restrictions are Perpetual

Although conservation easements are private transactions between landowners and grantee organizations, they have a fundamental effect on the present and future uses of the land. Probably the most important attribute of conservation easements is their perpetual nature. Most of the restrictions negotiated in easements will be in force indefinitely. Easement agreements provide protection for many of the state's wildlife species and sensitive habitats, but they also bind future generations to maintenance of land in its current uses. As explained in the next chapter, there has been significant growth in conservation easements over the years. It is likely this growth will continue and, as a result, the significance of this issue for public policymakers will also increase.

<p>Conclusion: Conservation easements now cover over 1.5 million acres in Montana and are a significant land use issue.</p>
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Chapter III – Conservation Easement Trends

Introduction

Our first audit objective also addressed historical trends in easement creation. Tracking trends in creation of conservation easements in Montana is possible because the Montana Natural Heritage Program (MNHP) collects attribute data showing starting dates for easement agreements. This chapter uses the MNHP data to analyze and discuss trends in easement creation in Montana. We also compare trends in Montana against data from other Rocky Mountain states and national conservation easement data.

Analysis of Conservation Easement Trends

Our discussion of easement trends in Rocky Mountain states is based on analysis conducted by Colorado College and the Property and Environment Research Center (based in Bozeman, Montana). National-level easement data is sourced from the Land Trust Alliance, a national membership organization for land trusts.

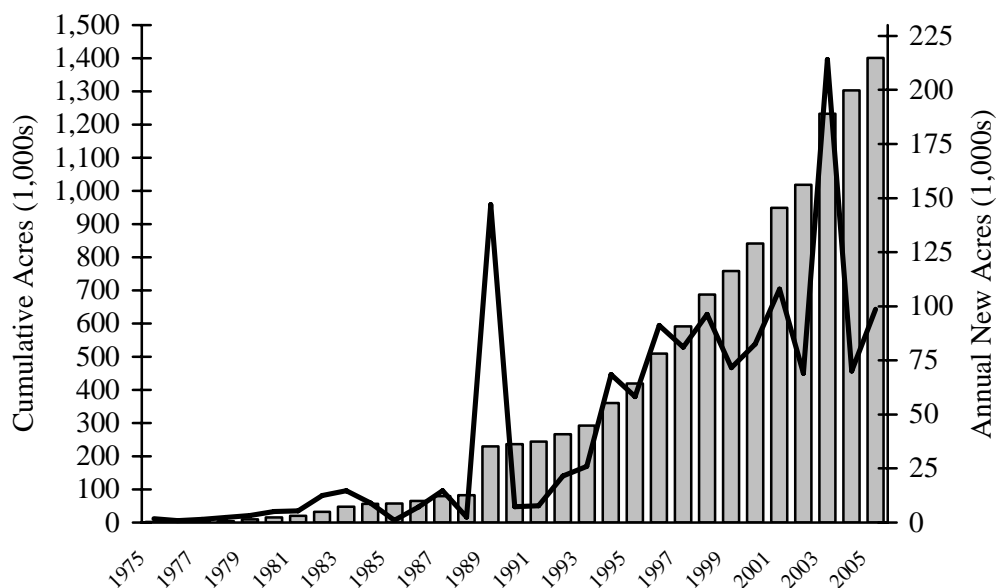
Conservation Easement Trends in Montana

Analysis of trends in easement creation in Montana addressed growth in the cumulative acreage under easement, number of acres put under easement annually, number of easement agreements, and average easement size. Data presented for Montana generally covers a 30-year period between 1975 and 2005. The following figure illustrates the trend in cumulative easement acreage (columns) and annual new easement acres (line).

Chapter III – Conservation Easement Trends

Figure 3

Trend in Cumulative and Annual New Easement Acreage
Calendar Years 1975-2005



Source: Compiled by the Legislative Audit Division from Montana Natural Heritage Program records.

As shown, there has been a steady increase in cumulative acres under conservation easement, from less than 10,000 acres in the 1970s to almost 1.5 million in 2005. There is considerable variation displayed in the annual addition of new acreage. Several years show significant spikes in easement activity, but the overall trend is towards larger annual totals for new acreage under easement.

Trends in the number of easement agreements created every year mirror those shown in the figure. Through the 1970s and 1980s, between 5 and 10 easements were created annually. Into the 1990s, the number of agreements created annually started to increase to between 50 and 100. These levels have been maintained since 2000 with an average of around 80 new agreements annually.

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There is considerable variation in average acreage of easements between 1975 and 2005. As shown in Figure 3, there have been years where new easement acreages spiked dramatically due to creation of one or several very large acreage easements. This is reflected in the trend for average acreage, which has varied considerably from year to year. However, the overall trend has been towards the creation of conservation easements covering larger acreages.

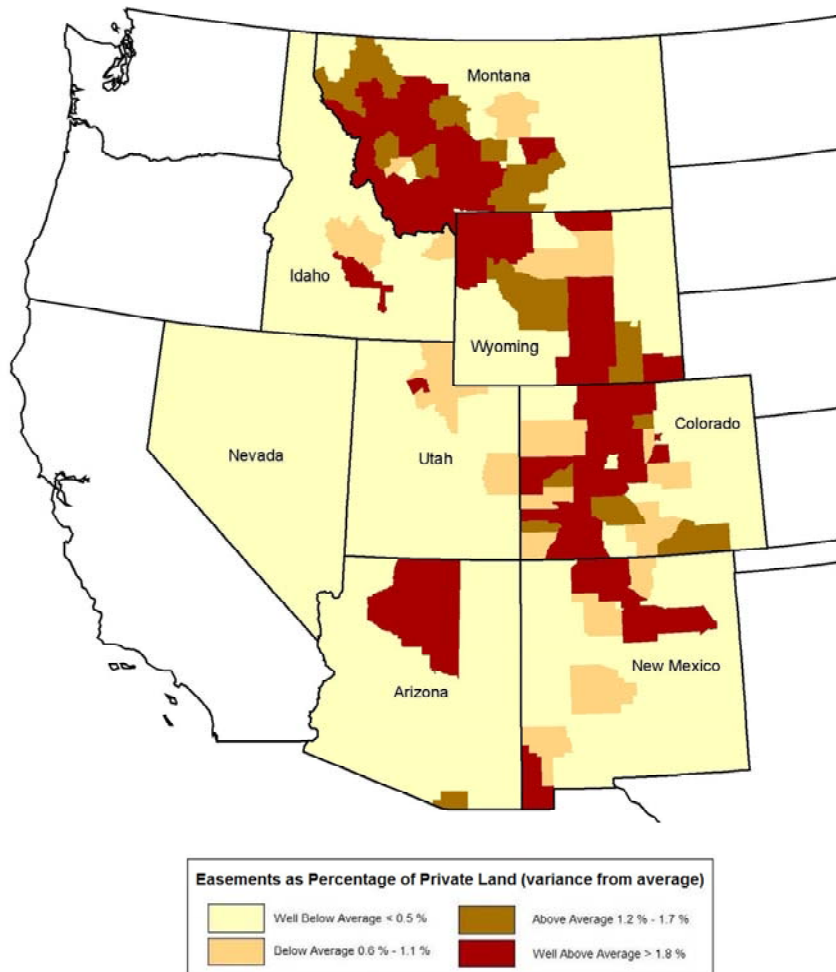
Conclusion: Over the past 20 years, increasing numbers of conservation easements have been created in Montana and the average land area covered in easement agreements has also increased.

Conservation Easement Trends in Western States

Evaluation of trends in conservation easements in other western states was limited by availability of data. The best example of a statewide data collection effort is found in Colorado's COMaP program, run through Colorado State University. The overall trends apparent in Montana easement activity are similar to those experienced in Colorado. Colorado has seen significant increases in the overall acreage under easement through the 1990s and the average size of the easements has also been increasing.

We also reviewed data sourced from the State of the Rockies Report compiled and published by Colorado College. This report contained information on creation of conservation easements in eight states in the Rocky Mountain west. Data compiled for this report shows how extensive conservation easement activity has been in different counties based on the percentage of private land under easement. This data is reproduced in the following figure.

Figure 4
Conservation Easement Trends in Rocky Mountain States



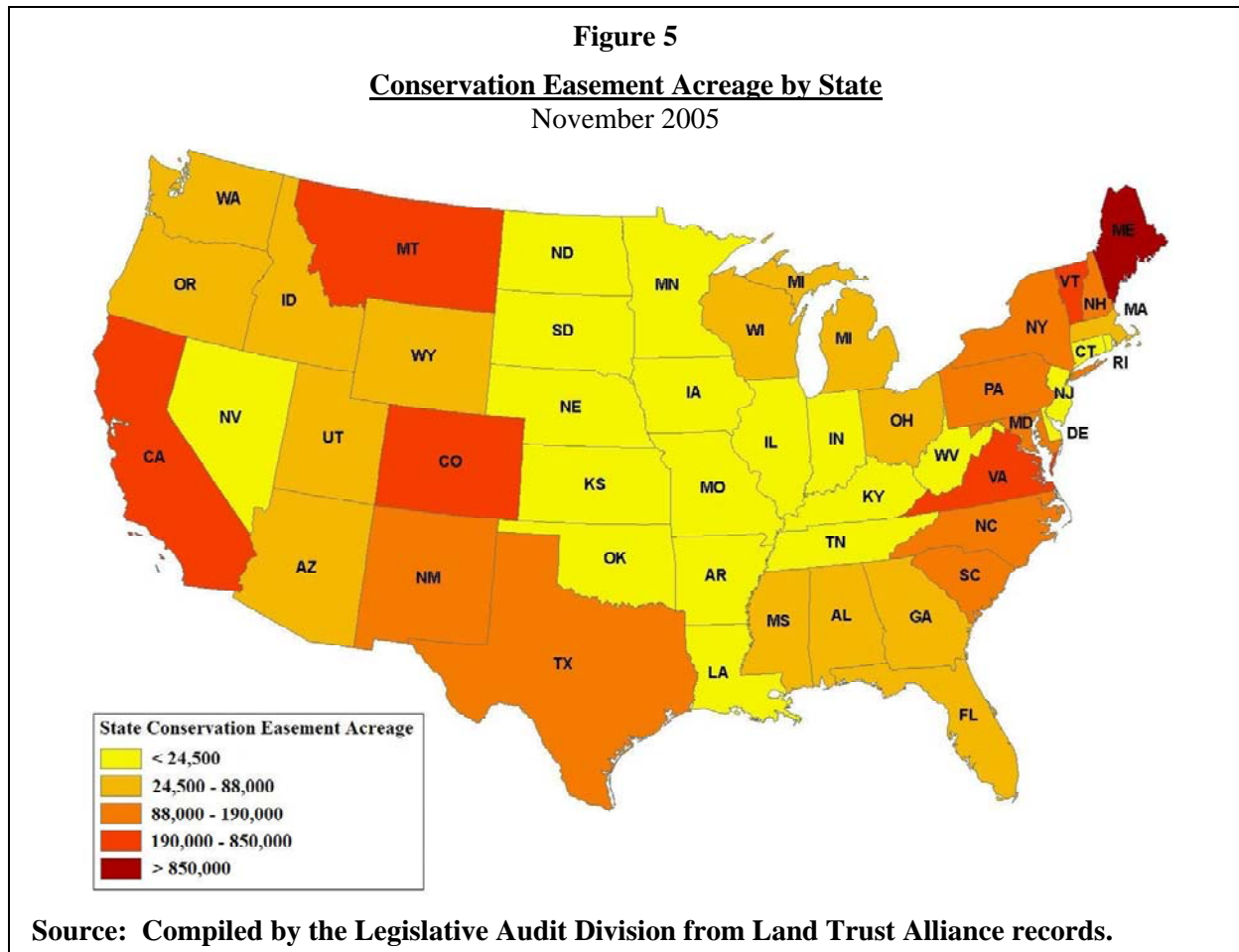
Source: Compiled by the Legislative Audit Division from information supplied for Colorado College.

Data classifies counties according to the proportion of private land covered by conservation easement (well below average, below average, above average, and well above average). As shown in the figure, easement activity has been most extensive along the continental divide and its constituent mountain ranges through western Montana, western Wyoming, central Colorado, and north-central New Mexico. Montana, Wyoming and Colorado appear to have seen the most extensive conservation easement activity in the Rocky Mountain west.

Chapter III – Conservation Easement Trends

National Land Trust Census Data and National Trends

The Land Trust Alliance (LTA) conducts biennial surveys of its membership to determine how many land trusts are in existence and how many acres of land are protected by these organizations. This data does not represent all conservation easement holdings throughout the nation because LTA only collects data from its own membership. However, the broad coverage of the LTA data provides a good representation of national trends in conservation easement activity. LTA data is currently available for 2005 for all states. The total easement acreage for each state is shown in the following figure.



Chapter III – Conservation Easement Trends

Figure 5 shows conservation easement activity has not been distributed evenly through the country. States in the north east and the Rocky Mountain west have seen significantly more acres being covered by easements when compared with other areas of the country. Trends in national LTA easement data also show increasing numbers of land trusts operating and increasing acreages under easement. LTA reports approximately 1,660 land trusts hold easements on around 6.2 million acres nationally. Montana's position relative to other states shows the state has experienced significant levels of conservation easement activity. The following table shows conservation easement acreage by state and as a percentage of total state land mass for the top 20 states.

Table 5
Proportion of Land Covered by Easement and
Total Easement Acreage by State (TOP 20)
 November 2005

<u>State</u>	<u>Land % Under Easement *</u>	<u>State</u>	<u>Easement Acreage *</u>
Maine	7.56%	Maine	1,492,279
Vermont	6.75%	Colorado	849,825
Maryland	3.06%	Montana	714,993
New Hampshire	2.33%	California	427,411
Virginia	1.44%	Vermont	399,681
Colorado	1.28%	Virginia	365,355
Massachusetts	1.23%	Maryland	191,330
Rhode Island	1.18%	New York	191,095
Connecticut	0.78%	New Mexico	142,072
Montana	0.77%	Pennsylvania	139,309
New York	0.63%	New Hampshire	133,836
South Carolina	0.51%	Texas	131,520
Pennsylvania	0.49%	North Carolina	112,874
California	0.43%	South Carolina	98,349
North Carolina	0.36%	Georgia	87,643
New Jersey	0.25%	Massachusetts	61,569
Georgia	0.24%	Michigan	54,762
Delaware	0.19%	Oregon	50,627
New Mexico	0.18%	Wyoming	49,358
Mississippi	0.16%	Alabama	48,428

* Acreage values for Land Trust Alliance members participating in survey.

Source: Compiled by the Legislative Audit Division from Land Trust Alliance records.

Chapter III – Conservation Easement Trends

Much of the most extensive easement activity has occurred in smaller north-eastern states where relatively small land areas have boosted the overall proportion of land covered by easement. For western states, Colorado and Montana are both highly placed relative to other states. Montana is the tenth most active state in the nation when easement activity is measured as a proportion of land mass.

Montana one of Nation's Leaders in Conservation Easement Activity

Comparisons with other western states and with the nation as a whole have shown Montana experiencing some of the highest levels of conservation easement activity in the country. The combined easement holdings of local land trusts, national conservation organizations, and state and federal agencies in Montana make this state one of the national leaders in the creation of conservation easements.

Conclusion: Conservation easement activity in Montana has been more extensive than many other states in the Rocky Mountain west and in the nation as a whole.

Few other states can match the extensive or varied nature of Montana's easement holdings and few others have had such wide experience in the debates surrounding easements. Between 2003 and 2005, the LTA reports their membership adding over one million acres in new conservation easements, which translates to a 23 percent increase in their holdings. The trend towards more easements covering more acreage has been particularly strong in the western United States and can probably be expected to continue. Given this situation, the public policy responses of leadership states like Montana is likely to be significant on the national as well as the local level. The remaining chapters of this report address easement creation in Montana and how changes could improve our knowledge and understanding of the associated issues.

Chapter IV – Conservation Easement Data Reporting

Introduction

Senate Joint Resolution (SJR) 20 requested the audit address access to information on conservation easements and recommend a method for compiling easement data in accessible formats. Under our audit objective addressing this issue, we performed work to evaluate the effectiveness of procedures for compiling and reporting conservation easement data. Audit work involved assessing the methods used to compile and report easement data at both the county and state levels. This chapter discusses findings relating to easement data reporting and includes recommendations to improve the reliability and accessibility of this information.

Recording of Easement Data at the County Level

Under Montana law (section 76-6-207, MCA), conservation easement agreements must be recorded in county land records and include a legal description of the property. These statutory provisions also require county clerk and recorders to maintain a separate file for conservation easements and ensure the Department of Revenue (DOR) receives copies of the easement agreements. To determine compliance with these laws, we conducted a survey and interviewed clerk and recorders regarding recordation and reporting for conservation easements. We also reviewed easement agreements and county land records in ten counties.

Survey of County Clerk and Recorders

We sent all Montana's clerk and recorders written questions regarding their procedures for recording and reporting on conservation easements. We received responses from 38 clerk and recorder offices. These responses showed a generally mixed picture in terms of compliance with state laws relating to conservation easements. For example, around half of respondents indicated they did not maintain a separate file for conservation easements and two respondents said they were unaware of this statutory provision. In relation to the requirement that easement agreements are mailed to DOR, around half of the respondents said they did not mail copies of the agreements to DOR.

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Audit Observations of County Conservation Easement Records

Responses to our survey of clerk and recorders were confirmed in our observations of county land records. During our review we identified two areas of inconsistency between counties, which are summarized as follows:

Conservation Easements as Legal Instruments – there was significant variety in the methods used to describe conservation easements as legal instruments. Conservation easements are generally recorded as deeds, but we identified a variety of different descriptions for the documents themselves.

Filing Methods and Database Configuration – we observed many different methods for recording easements in county land records. Some counties filed agreements in deed books, but others filed them as miscellaneous instruments. Some counties used specific descriptions for conservation easements, while others had an instrument description or notes field where the term ‘conservation easement’ was entered. Some counties had no method for specifically identifying these agreements.

Our observations and interviews with county officials indicate there is generally limited awareness regarding procedures relating to recordation and reporting of conservation easements. This has led to significant differences in the procedures counties use to compile and report data on conservation easements.

Conclusion: County officials have limited awareness of state laws relating to conservation easements and significant differences exist between county procedures for recording and reporting conservation easement data.

Lack of Coordination has Caused Inconsistencies

Statute assigns responsibility for collecting information relating to conservation easements to DOR. Audit work indicates that in the 30 years since Montana’s Open Space Land and Voluntary Conservation Easement Act was passed by the legislature, limited work has been conducted addressing reporting of easement data. At the county level, clerk and recorders do not appear to have been provided with clear or consistent guidance on their responsibilities in this regard. As the state agency assigned as the collection venue for

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this data, DOR bears responsibility for ensuring local governments follow standard procedures.

Even in situations where counties were reporting easement data to DOR, local staff received no instruction on what to do with the information. Agreements were generally reviewed to ensure provisions did not affect agricultural tax classifications, but no further actions were taken. Local DOR staff did not retain any data from the agreements and did not transfer any of the data to the DOR Property Tax Assessment Division in Helena.

Department of Revenue Should Address Procedures for Compiling Easement Data

Compliance with state law relating to recordation and reporting of conservation easements by counties is not uniform. As a result, data relating to conservation easements at the county level is difficult to identify and access. This situation may have been insignificant when conservation easements were relatively uncommon and covered small areas. However, as explained in chapters II and III, easements now constitute a significant land use issue and are likely to continue growing for years to come.

DOR could improve compilation of conservation easement data by working through local department staff to provide guidance and direction to clerk and recorders. DOR should develop procedures for local department staff to ensure conservation easement agreements are consistently received from clerk and recorder offices.

DOR should also develop procedures to ensure conservation easement attribute data is collected and maintained in statewide management information systems. The department currently uses the Computer Assisted Mass Appraisal (CAMA) system to maintain tax classification and other attribute data for the state's real property. Updating CAMA to include fields for conservation easement attributes would allow DOR to maintain statewide data in a consistent manner for all new conservation easements.

The CAMA system is already an integral part of the process used by DOR to maintain information on land ownership and use. Although

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conservation easements do not cause a transfer in ownership, the land use implications of easement creation are significant. Maintaining easement data in CAMA would ensure important information is available to policymakers addressing land use issues.

Recommendation #1

We recommend the Department of Revenue ensure county-level conservation easement data is compiled consistently by:

- A. Providing guidance on easement data collection to county clerk and recorders through local department staff; and**
- B. Updating CAMA to include conservation easement attribute fields.**

Reporting of Easement Data at the State Level

Audit work in relation to state agency procedures for compiling and reporting easement data included interviews with agency officials, identification of the functional roles and responsibilities of agencies relating to land information, and review of existing data reporting mechanisms. We identified three agencies or entities having some degree of involvement in reporting land information in general or conservation easements in particular. A discussion of our audit work and significant findings in relation to each of these organizations is summarized in the following sections.

Montana Natural Heritage Program – the Montana Natural Heritage Program’s main area of interest is species habitat and conservation, but land use and ownership are an important element of its work, so information on conservation easements is collected through surveys of easement grantees. The program’s work on conservation easements is conducted on a voluntary basis and is considered a secondary part of the program’s mission. MNHP has never been assigned responsibility for collecting the data and no specific funding mechanism was provided for it to do so. The aim of MNHP in collecting this data is to provide information relating to species conservation, not to provide information on land use issues.

Montana Department of Revenue – DOR is the only state agency referenced in statute relating to the compilation and reporting of conservation easement data. State law does not instruct the department what to do with the information received from counties. Staff in the Property Assessment Division have stated that because

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there is not believed to be any impact on property tax classification, they have not prioritized any kind of work addressing easements.

Department of Administration – the department’s Geographic Information Services Bureau is responsible for maintaining the Cadastral land ownership database. Cadastral is the state’s primary public access system for land records. The department does not currently have any role in compiling or reporting data relating to conservation easements. There is no established mechanism for transferring the data directly to the Cadastral layer through the CAMA system.

Responsibility of State Agencies for Data Collection

Statute does not clearly assign a role to any specific state agency relating to the reporting of conservation easement data. DOR has not been actively maintaining information relating to easements through the Property Tax Assessment Division or the CAMA system. DofA is not specifically assigned a role in statute relating to easements, although the Geographic Information Services Bureau does maintain the Cadastral system containing statewide land ownership data.

To date, compilation of statewide conservation easement data has relied on the voluntary efforts of the MNHP. MNHP is not directed under statute to compile or report this information and has not received specific funding to undertake this work. Collection of data relating to conservation easements is not considered part of the program’s core mission. Although MNHP continues to collect easement data for inclusion in its land stewardship layer, there is no guarantee these activities will continue to be prioritized in the future.

Conclusion: No state agency is assigned responsibility for compiling and reporting data on conservation easements.

Assessment of Alternative Approaches to Compiling Easement Data

To evaluate the advantages and disadvantages of approaches for compiling and reporting conservation easement data, we reviewed existing procedures at the MNHP, discussed alternative approaches with other state agencies, and reviewed procedures in other states.

Chapter IV – Conservation Easement Data Reporting

Role of the Montana Natural Heritage Program

Extensive testing was performed to determine the level of accuracy in the MNHP conservation easement data. As explained in Chapter II, audit work established MNHP conservation easement data is generally accurate and can be relied upon for the purposes of aggregate analysis. However, some concerns exist relating to this data, which are summarized as follows:

- ▶ Data is not 100 percent complete and attributes for all easements are not included (for example, not all the date fields have values).
- ▶ MNHP data is based on submission of data by easement grantees. The cooperation of grantees is voluntary and MNHP provides no assurances as to the accuracy of the information provided.
- ▶ Not all grantee organizations report data to MNHP in a timely fashion, and some grantees have chosen not to respond to requests for data in past years.
- ▶ There is no guarantee MNHP will continue to collect this data in future years or devote the same level of resources to maintaining the data set.

The decision by MNHP to collect and maintain data relating to conservation easements has been a considerable benefit to the state of Montana. The program conducted this work without specific directives to do so and with no dedicated funding. MNHP relies on the voluntary cooperation of grantees to provide updates and maintain the data set. However, the voluntary nature of the MNHP data collection efforts means it is impossible to establish complete assurance over the accuracy and completeness of the data.

Montana Cadastral Database

State government's primary mechanism for compiling and reporting land ownership data is the Cadastral system maintained by DofA. The CAMA and Cadastral systems already act as a means of transferring land ownership data from county land records to a statewide public access system. Information from recorded documents submitted to county clerk and recorder offices is transferred to local DOR staff. Cadastral data is updated on a monthly basis using the attributes contained in CAMA and is publicly available.

Chapter IV – Conservation Easement Data Reporting

Approaches from Other States

We reviewed availability of conservation easement data in other states to determine how Montana's data collection procedures compare. Overall, it appears that Montana's efforts to compile and report conservation easement data are more advanced than the majority of other states. We identified one national program addressing the conservation status of land and two examples of state programs compiling this type of information. These other programs are the National Gap Analysis Program conducted through the United States Geological Survey, the Maine State Planning Office's state conservation lands layer, and Colorado State University's COMaP program.

Montana Has Advantages in Conservation Easement Data Collection

Montana has considerable advantages over other states in compiling and reporting conservation easement data. The land stewardship data maintained by the MNHP is probably one of the most complete and accurate records of conservation easement locations available in the country. However, voluntary data collection efforts will always have a limited level of accuracy and completeness and improvements could be made. Montana also has an advantage over other states in that there are existing mechanisms and procedures in place allowing for land ownership and use attributes to be transferred into a statewide database (the Cadastral system). The compilation and reporting of statewide conservation easement data could be improved through use of alternative data collection and management mechanisms.

Conclusion: Montana's approach to compiling and reporting conservation easement data has been more successful than other states, but alternative approaches to collecting this data could result in improvements in accuracy and reliability.

More Accurate Easement Data Requires a New Approach

Although Montana already has considerably better easement information than many other states, it could be argued Montana has experienced a far greater level of conservation easement activity. It could also be argued that due to the high level of interest in conservation easements in Montana, the state has always been ahead of the nation in developing procedural mechanisms for conservation

Chapter IV – Conservation Easement Data Reporting

easements. When these factors are considered together with the fact that Montana's Cadastral system provides a means for collecting easement data, it is possible to identify potential improvements in the state's ability to compile and report conservation easement data effectively.

The accuracy and reliability of easement data available to policymakers could be improved through integration with existing statewide information systems. Developing procedures to ensure conservation easement data recorded in county land records is transferred to the statewide level will provide improvements in accuracy and completeness. Integration in existing data collection procedures will also ensure conservation easement data is maintained and updated consistently and is available via established and reliable access methods. Integration of easement data from counties in CAMA is addressed in our first recommendation. In addition to this, DofA should develop procedures to allow for the inclusion of conservation easement data in the Cadastral system and provide for public access to the information.

Recommendation #2

We recommend the Department of Administration develop procedures to allow for the integration of conservation easement data in the Cadastral system.

Findings Address Easement Data Concerns from SJR 20

SJR 20 indicated dissatisfaction with the availability and accessibility of information on conservation easements. The resolution also requested we identify alternative means for compiling and reporting easement data. Audit work identified certain weaknesses in the current voluntary approach to collecting easement data. Data compiled by MNHP has been important in developing an understanding of conservation easements, but a formalized approach to compiling and reporting this information would result in improvements. The approach recommended in this chapter involves directing DOR resources to collecting easement data from counties and integrating this information in the Cadastral system. Integrating

Chapter IV – Conservation Easement Data Reporting

easement data in Cadastral should improve the reliability and accuracy of the information and allow for easy public access.

Improved Data Could Support Policy Decisions

Improving data compilation and reporting could provide better information and improve policy making relating to easements. As discussed in the remaining chapters of this report, the public policy issues relating to easements are becoming more significant. As Montana continues as a national leader in conservation easement activity, the basis for policy decisions here will likely serve as a model for developments in other states.

Chapter V – Property Taxes and Land Values

Introduction

Debates relating to conservation easements often focus on perceived impacts on local property taxes. Our audit objectives addressed the potential impacts on local property tax collections. Audit work in this area involved testing and analysis of property tax classification data obtained from the Department of Revenue (DOR). We also reviewed studies addressing fiscal impacts on local governments resulting from open space preservation efforts. Additional audit work addressed the effects of conservation easements on land transfers and values.

State Law Relating to Property Taxes and Easements

Unlike some other states, Montana statute does not provide property tax incentives for creation of conservation easements through reductions in taxable value. Montana law actually seeks to ensure conservation easement creation is fiscally neutral for local governments. Statutory provisions recognize that conservation easement restrictions can impact the taxable value of a property, but also seek to prevent revaluation of properties in a manner that could adversely affect local tax collections. Section 76-6-208, MCA, reads in part “assessments made for taxation on property subject to a conservation easement... shall be determined on the basis of the restricted purposes for which the property may be used. The minimum assessed value for land subject to an easement conveyed under this chapter may not be less than the actual assessed value of such land in calendar year 1973. Any land subject to such easement may not be classified into a class affording a lesser assessed valuation solely by reason of the creation of the easement.”

Statutory Provisions Should Prevent Reclassification of Easement Properties

In practice, these statutory provisions mean where an easement prohibits certain activities or uses, assessment of taxable value should account for the restrictions (for example, if an easement prohibits all farming on land classified as agricultural for tax purposes, the property should be reassessed in a different, non-agricultural class of property). However, statute also establishes a historical baseline value for easement properties and does not allow assessed taxable value to fall beneath this level. The assessed value for easement properties cannot be less than the assessed value of the

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land in calendar year 1973. Additionally, easement properties cannot be reclassified solely on the basis of the easement (for example, even if easement provisions would result in significant land use changes affecting tax classification, the owner would have to demonstrate that other changes in use unrelated to the easement occurred and that these alone were sufficient to support reclassification).

Conclusion: The intended effect of statutory provisions is to make it highly unlikely an easement property could be reclassified for tax purposes in a manner that would adversely impact property tax collections.

Examination of Tax Records for Easement Properties

To determine whether any changes in property tax classification occurred as a result of easement creation, we obtained and reviewed tax classification data for conservation easement properties. We selected properties where the easement was created at some point between the two most recent DOR property tax reappraisal cycles in 1997 and 2003. DOR staff in the Property Assessment Division performed a system query to identify classification and value data for these parcels for the 1997 reappraisal cycle and the 2003 reappraisal cycle, thus returning a before and after picture of the tax status of the property on either side of easement creation.

Analysis of Classification Data for Easement Properties

We reviewed tax records for 2,185 individual parcels from approximately 400 different conservation easement properties. This analysis showed there were no changes in classification for the parcels included in our review. All of the properties assessed in a certain class in 1997 remained in this class following the 2003 reappraisal. There are several reasons why no changes were observed in the tax classification of these properties.

- ▶ **Existing use** – most easement properties (75 percent) are already classified in agricultural or timber use. These properties are already assessed at the lowest level possible and any reclassification can only be upwards.
- ▶ **Acreage** – easement properties tend to be larger in size. Only 11 percent of easement properties are less than 20 acres and the majority (nearly 70 percent), are larger than the 160 acre

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threshold established for agricultural classification. These large acreage rural properties are very unlikely to be reclassified, unless significant subdivision occurs.

- ▶ **Easement restrictions** – easement agreements generally prevent development on a scale that would result in property tax reclassification. Unlike most real estate, easement properties are unlikely to see major changes in land use.

This analysis clearly indicates the creation of conservation easements has not resulted in immediate adverse impacts on local property tax collections. The negotiation of conservation easement agreements for the properties included in our review did not result in reclassification of the land for tax purposes.

Conclusion: Creation of conservation easements has not resulted in reclassification of property for local property tax purposes.

Trends in Taxable Value of Easement Properties

Trends in the taxable value of easement properties show agricultural properties and residential properties experienced similar levels of growth between 1997 and 2003. All of the easement properties where data was retrieved by DOR fell into three class codes; Class 3 (agricultural), Class 4 (residential and other improvements), and Class 10 (timberlands). Grouped by class codes the data showed residential properties made up the largest share of the overall taxable value, followed by timberlands, and then agricultural properties. These proportions are generally in line with what should be expected. Residential properties are taxed at a higher rate because they are assessed based on market value, whereas timber and agricultural lands are taxed based on productivity value.

A more significant issue was apparent when taxable value data for conservation easement properties was compared against DOR property tax data for all state properties. The following table shows the current percentages and 6-year trends in taxable value for the three property classes discussed in relation to easements. Values for all state properties and conservation easement properties are included.

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Table 6

Trends in Taxable Value for Montana Properties and Easement Properties

<u>Property Tax Class</u>	<u>Statewide Taxable Value *</u>		<u>Conservation Easement Taxable Value</u>	
	Current Percentage	6-Year Trend	Current Percentage	6-Year Trend
Class 3 - Agricultural	11 %	+ 0.5 %	18 %	+ 16 %
Class 4 – Residential	88 %	+ 20 %	62 %	+ 16 %
Class 10 - Timberlands	1 %	- 20 %	21 %	+ 7 %

*Percentages based on the total of the three property classes shown and exclude additional property tax classes.

Source: Compiled by the Legislative Audit Division from Department of Revenue records.

As shown, there are significant differences between the proportions of, and trends in taxable value for the three property classes when conservation easements are compared against statewide totals. For all state properties there is a trend towards residential classes contributing a greater proportion of overall taxable value and growing at a faster rate when compared with agricultural and timberlands. This is not the case for conservation easement properties, where agricultural and timberlands generate a larger proportion of taxable value and, in the case of agricultural land, are growing at a rate comparable to residential properties.

Conservation Easements Have Potential to Result in Shifts in Tax Collections

Because conservation easements restrict the scope for significant changes in land use, it should not be surprising that changes in tax valuations for easement properties do not correspond with prevailing state trends. Statewide, more properties are being developed with residential improvements resulting in Class 4 assessment and fewer properties are being devoted to traditional agricultural and timber uses. Easements generally prevent development of land in a manner that would result in reclassification of the entire acreage, so agricultural and timberland uses continue to predominate where there

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would otherwise be potential for more intensive development to occur.

These circumstances indicate the creation of conservation easements has the potential to result in shifts in property tax collections for local governments over the long term. Assuming growth rates for residential development continue at current levels, these shifts could occur in specific counties with extensive easement development. Where easement activity within a specific county is particularly extensive, it should be expected that traditional agricultural and timberland uses will not follow prevailing trends.

Conclusion: Extensive conservation easements within specific counties could have the potential to result in shifts in property tax collections over the long term.

While there is clearly potential for conservation easements to have some effect on tax collections, it is far from clear how significant these shifts could be or whether there will be any direct fiscal impact on local governments. The issue of fiscal impact is discussed in the next section.

Fiscal Impacts on Local Governments

To determine whether conservation easements have any direct fiscal impact on local governments, we reviewed studies and analysis relating to costs associated with various forms of land use and development. These studies have been a common factor in many discussions of conservation easements and are generally referred to as Cost of Community Services (COCS) studies. COCS studies seek to quantify the costs to local governments of providing services to different land use types and then compare these costs against property taxes generated. The comparison of how many dollars worth of government services are demanded versus how many tax dollars are received produces a COCS ratio for different land use types. If this ratio is greater than 1:1, the costs associated with the land use type are greater than the taxes generated.

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COCS Studies Consistently Support Open Space

COCS studies conducted by the American Farmland Trust (AFT) and other organizations consistently find residential development does not pay for itself when compared against agricultural/timber lands and other open space. Commercial and industrial development are also net contributors to local governments. A recent report found that for 70 AFT studies performed, residential development requires an average of \$1.15 in government services for every \$1 in property taxes generated (COCS ratio of 1.15:1). This compares with a 0.35:1 ratio for farm and forest land and a 0.27:1 ratio for commercial and industrial uses. The COCS approach suggests that property taxes generated by residential land uses are not sufficient to cover the costs of providing government services to residents, such as roads, utilities or schools.

Methodological Concerns with COCS Approach

COCS studies have the advantage of resulting in analysis that is easy to understand and relates well to local circumstances. However, the popularity of this approach should not mitigate several important concerns regarding the methodological soundness of COCS studies. These concerns relate mainly to the factors not accounted for in the COCS approach and are summarized as follows.

- ▶ **Geographic scope** – COCS studies tend to address single local jurisdictions (cities or counties) where specific circumstances could affect results. Extending the scope of the studies to the state level would provide a better basis for many policy decisions.
- ▶ **Longitudinal data** – COCS studies tend to take a snapshot in time, rather than assessing longitudinal data over a number of years. Changes in tax structures, levels of public investment or service provision are not accounted for in this approach.
- ▶ **Economies of scale** – the COCS approach does not account for economies of scale in the delivery of government services. Provision of public infrastructure can benefit from economies of scale as the cost of delivering services to more people may decrease on a unit basis with the addition of more residents.
- ▶ **Excess capacity** – COCS studies ignore the potential for public infrastructure to absorb extra demand through existing capacity.
- ▶ **Multiplier effect** – COCS studies do not account for the economic multiplier effects of adding new residents and focus exclusively on local government service provision. This

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approach ignores the fact that new residents work in local businesses, purchase goods and services locally and have other effects on the broader economy.

Taken together, these methodological concerns do not invalidate the COCS approach, but they do suggest these studies have limitations and should be used with caution. From Montana's perspective, another issue is COCS studies have not been conducted in many Montana jurisdictions. AFT has reported that three COCS studies have been conducted in Montana counties. No statewide studies have been conducted for Montana and making conclusions based on only three county studies would be problematic.

Fiscal Impact Analysis of Conservation Easements

Currently, there is no reliable evidence that conservation easements have had either a positive or negative impact on local government finances. The findings from numerous COCS studies suggest easements may result in counties incurring lower costs associated with infrastructure and service provision for residential land uses. However, considerable methodological concerns would have to be remedied before the COCS approach could be applied to conservation easements in Montana.

Determining with some degree of certainty whether the creation of conservation easements in Montana has increased or reduced property tax revenues would involve conducting a detailed fiscal impact analysis for multiple counties over several years. While there is no guarantee this type of econometric analysis would provide definitive findings, it could advance understanding of the potential fiscal impacts of easements.

<p>Conclusion: Current evidence relating to fiscal impacts on local governments resulting from open space preservation is unreliable.</p>
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Land Transfers and Values

There is also the potential for conservation easements to impact property taxes indirectly through transfers to government entities or effects on land values. Effects on property taxes could result from changes in tax classification where an easement property is sold to a

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governmental entity. Additionally, because easements restrict land use, there could be effects on the market value of properties. Significant changes in market values for easement properties could result in changes in taxable value, where the properties are assessed on a market basis. Audit work involved obtaining transfer and sale value data from DOR for easement properties and for adjacent lands.

Transfer of Easement Properties to Governmental Entities

One common concern relating to easement creation is the potential for governmental entities to negotiate an easement and then take advantage of a subsequent reduction in land value to purchase the property. If these kinds of transfers occurred on a regular basis, local property tax collections could be impacted as governmental ownership would result in exemption from taxation. Our review of DOR transfer data identified only two parcels currently in government ownership where a transfer had occurred within the past 12 years. It was not clear in either case that a private land owner had sold the property to a government agency, or if the agency had acquired the land from some other source. Regardless, this review showed there is minimal evidence of easements resulting in governmental ownership of land. There is certainly no evidence that transfers to governmental entities could have a significant effect on local property tax collections.

Changes in Value for Easement Parcels

We also reviewed changes in market values for easement properties by comparing a sale event for a parcel prior to easement creation and any subsequent sale that may have occurred. We identified sales data for 12 different easement properties using this method. This limited sample does not provide a statistical basis for any judgment regarding effects on value, but it does indicate easements should not be presumed to have a negative impact on market value. For the 12 properties we identified, 10 saw an increase in market value after the easement was created. Overall, the median value of these properties increased by around \$55,000 or 35 percent. This finding supports the view that easements do not necessarily result in reductions in land values. This information is also important in relation to public oversight of easement transactions and is discussed in more detail in Chapter VII.

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Data Limitation for Adjacent Properties

Our analysis of land values also involved an attempt to obtain data for changes in land values for properties adjacent to conservation easements. A query of the DOR data for approximately 35,000 adjacent parcels failed to produce a sufficient sample of sales events to provide any basis for analysis. As a result, we are unable to provide conclusions relating to any potential impact from conservation easements on the market value of adjacent properties.

Conclusion: Creation of conservation easements has not resulted in significant transfers of private land into public ownership. Property tax impacts resulting from changes in market values for easement properties are unclear, but easement creation does not necessarily result in reduction in market value.

Significant Impacts of Easements Seen in Public Funding

Further analysis of conservation easement creation and local government tax structures would be required to determine whether significant impacts exist. To date, there is no clear evidence that conservation easements are either helping or harming local government tax collections. While there is work remaining to determine the impact of conservation easements on property taxes, our audit work indicates there is a significant impact as measured by the levels of direct and indirect public funding for easements. The creation of a conservation easement may be a private transaction, but taxpayers have provided considerable levels of support for these agreements through direct and indirect means. The level of public support for conservation easements is discussed in the next chapter.

Chapter VI – Public Funding for Conservation Easements

Introduction

The private nature of conservation easement transactions is often cited as one of their primary advantages. However, creation of conservation easements in Montana has been supported by both direct and indirect public funding. This funding has been in the form of direct acquisition payments and incentives provided through the tax code. Our audit objectives addressed the level of public funding dedicated towards easement creation in Montana. The following sections contain discussion and findings relating to both direct and indirect funding, and future trends in public support for easement creation.

Direct Public Funding

Direct public funding for conservation easements is generally in the form of payment to land owners for a portion of the value of the easement. Easements are acquired in this manner by federal and state agencies, and local governments. In some cases the government entity retains and manages the easement, in others a land trust or similar organization is assigned responsibility for management. Audit work focused on easement acquisition programs in state and county governments in Montana.

Department of Fish, Wildlife and Parks Conservation Easement Program

The Department of Fish, Wildlife and Parks (FWP) acquires conservation easements for various purposes including protection of important wildlife habitat, protection of areas adjacent to existing FWP land, and provision of access to recreational sites. The majority of the department's easement acquisition is conducted under the Habitat Montana program and funded mainly through general license revenues. However, FWP payments to land owners can also consist of donated private moneys and federal funds.

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FWP prefers to acquire easements through direct payments to land owners, although payments are generally made on a bargain sale basis where significantly less than full value is paid. We obtained information from the Legislative Audit Division's 2005 Financial-Compliance audit of the department showing recorded FWP conservation easement acquisitions. The following table summarizes data for all FWP conservation easement acquisitions currently listed in the department's 2005 Landbook.

Table 7	
<u>Summary Information for FWP Conservation Easement Acquisitions</u>	
Through 2005	
<u>FWP Conservation Easement Data</u>	<u>Values</u>
Total Acquisition Cost	\$ 58,166,577
Total Conservation Easement Acreage *	370,472
Average Acquisition Cost	\$1,163,332
Average Easement Acreage	7,409
Average Cost Per Acre	\$ 157

*Total acreage from 2005 Landbook with associated acquisition costs. Does not equal updated information for 2006 included in FWP acreage reported in Chapter II.

Source: Compiled by the Legislative Audit Division from Department of Fish, Wildlife and Parks records.

The first recorded easement acquisition by FWP is listed in 1983. Since then, the department has entered into approximately 50 conservation easement agreements for a total acquisition cost of approximately \$60 million. The size of FWP easements ranges from small areas, less than 100 acres, to very large easement complexes, such as the Thompson-Fisher Creek project covering over 140,000 acres. The acquisition of the Thompson-Fisher Creek conservation easement was the single largest expenditure under the FWP program at around \$32 million and also consisted of federal and private grant funds expended by the department.

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Local Government Open Space Bond Issues

Several county governments in Montana have developed or are in the process of developing open space programs funded through municipal bond issues. These open space programs generally rely to a large extent on acquisition of conservation easements, but also involve fee simple acquisitions. Bond issues are usually submitted as ballot issues requiring voter consent. In 2000 and again in 2004, voters in Gallatin County approved open space bond issues totaling \$20 million. Gallatin County has an active open space preservation program and currently reports 17 conservation easement acquisitions. As discussed below, voters in at least two other counties have also approved open space bond issues.

Future Trends in Direct Support for Conservation Easements

At both the state and county levels, use of conservation easements as a method of preserving open space can be expected to continue. FWP easement acquisitions allow the department to meet goals relating to conservation and provision of recreational opportunities without the high costs of fee simple ownership. In 2006, voters in Missoula and Ravalli counties approved open space bond issues valued at \$10 million each. Together with Gallatin County, these new issues mean around \$40 million in total public funding at the county level, has or will be available for conservation easement creation and other open space preservation efforts.

Indirect Public Support

In addition to direct public support, creation of conservation easements in Montana has been supported indirectly through state income tax deductions for charitable contributions of easements. The federal tax code specifically allows for deductibility of charitable contributions in the form of partial interests in real property (a conservation easement), and these provisions have been important incentives for conservation easement activity nationally.

Federal Tax Deductions Available for Conservation Easements

The federal tax code provides incentives for conservation easements because the easement value can be claimed as a donation or charitable contribution to the grantee. Federal law contains a specific allowance for these donations, referred to as “qualified conservation contributions.” Individuals can deduct the easement value up to a limit of 30 percent of their adjusted gross income in a

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single tax year. This deduction can also be carried forward over the next five tax years. Corporate entities are also eligible for this deduction, but the deduction cannot exceed 10 percent of gross income. Federal tax laws also provide estate tax benefits associated with easement creation.

Tax Deductions Available for Montana Tax Payers

Montana tax law allows income tax deductions available at the federal level to flow through to Montana tax returns, unless specifically prevented from doing so. This means a conservation easement grantor in Montana can claim an income tax deduction for the easement as a charitable contribution. Estimating the value of these deductions provides some indication of the level of indirect public funding for easements. Indirect public funding for easements is therefore available in the form of a tax expenditure. Tax expenditures measure the amount of potential tax revenue not collected as a result of provisions such as deductions or credits.

Indirect Public Funding Estimation Methodologies

To collect data for this analysis, we reviewed information from other states and accessed Montana individual and corporate tax returns for tax years 2003 and 2004 for individuals or corporations owning land where conservation easements were created during these two years. We used several different methodologies to estimate the potential level of indirect public support for easement development. These approaches are discussed below.

State tax credits – state tax credits work by giving tax payers a direct reduction in their tax liability. We obtained information for state credit programs in Colorado, South Carolina, Connecticut and New Mexico. We calculated an average credit or benefit available to taxpayers in these states. Tax credits work differently from deductions, but the benefits are likely to be comparable with those available through deductions.

Marginal tax rate – a more direct method of assessing state tax deductibility for easements uses marginal tax rates. Applying the marginal rate to the total easement deduction produces an estimate of the individual tax benefit. This method has the benefit of being relatively simple, but it may not provide a true picture of the actual impact of easement deductions, because its basis is marginal tax rates and individual benefits.

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Tax expenditure ratio – an alternative method uses Department of Revenue (DOR) tax expenditure data for charitable deductions. This approach relies on estimates of actual tax expenditure associated with different types of deductions. This approach is more direct than the marginal tax rate approach and is based on data produced directly by Montana's DOR, so it could be seen as more reliable.

Itemized deductions – this approach accounts for the fact that most easement grantors are in high income brackets and tend to itemize deductions. The approach estimates a value for the easement deduction as a proportion of the individual's total itemized deductions. This method relies on a less generalized approach to calculating individual deductions and also takes into account the effect of additional itemization by tax payers.

All of the estimation methodologies discussed are non-statistical and are not represented as the actual fiscal impacts of tax deductions on the state's General Fund. They are estimates and all rely to some extent on certain assumptions regarding participation in state tax deductions for easements, but the analysis was conducted based on conservative assumptions. The following table presents summarized estimates for each method and also includes the median values for adjusted gross income and easement value we collected during examination of individual and corporate tax records.

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Table 8

Estimates of General Fund Impact from Tax Deductibility for Conservation Easements
Tax Years 1995 through 2005

<u>Methodology</u>	<u>Cumulative Estimate 1995 – 2005 (millions)</u>	<u>Annual Estimate (millions)</u>
State Tax Credit	\$17.0	\$1.7
Marginal Tax Rate	\$26.7	\$2.4
Tax Expenditure Ratio	\$19.9	\$1.8
Itemized Deduction (specific)	\$24.4	\$2.2
Itemized Deduction (generalized)	\$33.2	\$3.0
<u>Data Calculated from Tax Return Review</u>		<u>Value</u>
Easement Grantor Median Adjusted Gross Income		\$305,605
Median Conservation Easement Value		\$348,500

Source: Compiled by the Legislative Audit Division from Department of Revenue records and data obtained from other states.

The estimated impact on the state's General Fund is between \$17 and \$33 million over 10 years. This would mean an annual impact of between \$1.7 and \$3 million. Our analysis also shows median adjusted gross income for easement grantors is around \$300,000 and the median value of the easement contribution is around \$350,000 (we used these values in some of the estimation methodologies).

Future Trends in Tax Treatment of Conservation Easement

Changes in the federal tax code have resulted in expansion of deductions available to easement grantors and could impact levels of indirect public funding for conservation easements in future years. Provisions of the 2006 Pension Protection Act increase the proportion of adjusted gross income an individual can claim as an easement deduction from 30 percent to 50 percent. Additionally, the carry forward period is extended from 5 years to 15 years. Other provisions of the act apply only to agricultural producers and increase the income limit to 100 percent and extend the carry forward period to 15 years. These provisions are only applicable for

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the 2006 and 2007 federal tax years, but could be extended by future legislation.

Assuming additional easement activity associated with enhanced incentives, changes in federal tax laws could impact indirect public support for easements in Montana. Enhanced incentives could raise awareness of potential tax benefits of easement creation and cause more land owners to enter into agreements. The changes in income limitations and carry forward periods could also result in larger deductions for Montana tax payers and corresponding increases in the impact on the State Treasury.

Significant Direct and Indirect Public Support Provided for Easements

The cumulative impact of direct and indirect public support for conservation easements has been considerable. Although precise calculations of public funding are difficult, the combination of acquisitions made through state agencies, municipal bond issues, and deduction of easement value from state income taxes have resulted in the dedication of over \$100 million in public funding to support easement creation. This should be considered a conservative estimate as it does not include acquisitions by federal agencies, does not extend estimates of state tax deductions beyond a 10-year period, and does not account for impacts resulting from federal and state estate tax benefits. Given changes in the federal tax code, it is likely the level of indirect public support will increase, at least in the short to medium term.

Conclusion: Over \$100 million in direct and indirect public funding has been or will be used in the creation of conservation easements in Montana. This level of support can be expected to increase in future years.

Conservation Easements and Public Trust

The significant level of public funding for conservation easements establishes a duty of public trust for both grantors and grantees. Public funding can either directly or indirectly benefit easement grantors and it should be expected that they uphold this duty of trust by complying with relevant laws, negotiating in good faith, and upholding their responsibilities as outlined in the easement

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agreement. Easement grantees must also uphold this duty of public trust and, if anything, their role in this regard is more important. An important aspect of upholding the public trust is the assurance that appropriate oversight is being conducted. As discussed in the final chapter of this report, the level of public oversight of conservation easements in Montana is limited and this raises questions regarding accountability and public trust.

Chapter VII – Public Oversight of Conservation Easements

Introduction

Our final audit objective addressed the extent to which conservation easements are being written and enforced to protect conservation values. As defined in federal law, the protection of conservation values is central to the duty of public trust established by an easement agreement. Both grantors and grantees have a responsibility to ensure the public trust is upheld in easement transactions, but provision of significant public funding for easements also highlights the question of public oversight. This chapter addresses whether conservation easement transactions receive effective public oversight and includes audit findings relating to protection of conservation values in easement agreements.

Legal Standards for Conservation Easements

Federal law and codified regulations establish definitions for the conservation purpose of easements as charitable contributions. Federal statute allows conservation easements to be treated as charitable contributions if they meet defined conditions. As currently constructed, federal law allows for the development of conservation easements in a wide variety of circumstances and for a variety of reasons. The definition of conservation purposes in federal law are relatively broad and allow for creation of conservation easements on land that has already been developed to some degree and also allow for additional development to take place, as long as the test of public benefit is still met.

State Law Provides Little Additional Guidance

Montana statute provides relatively little additional guidance relative to creation of conservation easements. The only section of statute providing some guidance is section 76-6-203, MCA, which defines activities a conservation easement can restrict (examples include construction, landfill or sub-division). However, statutory language in this section is permissive and there is no requirement that certain kinds of developments are prohibited.

Existing Oversight of Conservation Easements

Several existing mechanisms provide opportunities for oversight of conservation values in easement agreements. These include federal and state tax examination/audit functions, and land trust codes of

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practice and monitoring procedures. These mechanisms are discussed in the sections below.

Oversight Authority Exercised Through the Tax Code

Because conservation easements are defined primarily through the federal tax code, IRS is the government agency responsible for assessing public benefit and enforcing rules relating to charitable contributions of easements. Discussions with IRS officials working in this area indicate that although enforcement efforts are being increased, the level of effort involved is limited and the agency applies relatively high materiality limits to easement audits. Currently, the Montana Department of Revenue (DOR) conducts no oversight or review of conservation easements claimed as charitable contributions. The department does not require submission of federal schedules associated with these contributions, and does not specifically review the terms of easement agreements to ensure they meet legal standards or that appraised values are appropriate.

Land Trust Standards and Practices

Where easement grantees are members of the Land Trust Alliance (LTA), a code of practice exists to ensure agreements comply with the law and are meeting public benefit standards. Various standards within the LTA guidance address policies and procedures land trusts should adopt to ensure the public benefit is paramount in easement agreements. Adherence to these standards is necessary for organizations wishing to attain accreditation by LTA, but LTA membership is voluntary and participation is not a requirement for an organization wishing to develop conservation easements in any part of the country.

LTA Standards and Practices include procedures for land trust monitoring of properties subject to easements. To gain a better understanding of how these monitoring procedures work, we observed monitoring visits conducted by The Nature Conservancy and Montana Land Reliance. These observations show the organizations have active monitoring efforts and follow appropriate monitoring procedures. Observations also indicate grantees are maintaining adequate documentation regarding the status of their

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properties and have procedures in place to track and monitor their holdings.

Assessment of Public Benefit Depends on Voluntary Effort

Currently, assessment of the public benefit of conservation easements is conducted largely by easement grantees. Federal oversight by IRS is intermittent, focuses only on high-value easements, is dependent on scarce resources, and does not address Montana's specific circumstances. Montana's DOR has not prioritized conservation easement charitable contributions for oversight or audit/examination. In these circumstances, the best assurances available regarding the public benefit of easement transactions rely on the voluntary cooperation of grantors and grantees.

Review of Easement Agreement Attributes

To address the question of public benefit in easement agreements, we reviewed around 120 different conservation easements in 10 different counties. Our review of easement agreements in counties showed a wide range of permitted and restricted activities. Conservation easements are developed to meet a diverse range of goals and objectives; some easement agreements are very restrictive and allow virtually no development; other agreements are relatively permissive and allow for residential and other development to some extent. The following table contains attribute information collected from the easement agreements we reviewed.

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Table 9

Selected Attributes from Conservation Easement Agreements

Calendar years 1980-2004

<u>Attribute / Activity</u>	<u>Proportion of Sample</u>
Residential Construction Permitted	71 %
Transfer/Division of Land Permitted	22 %
Minerals Exploration/Exploitation Permitted	16 %
Timber Harvest/Management Permitted	26 %
Easement Agreements with Amendments	7.5%
Easement Agreements Permitting Public Access	3 %

Source: Compiled by the Legislative Audit Division from county land records.

This attribute data shows it is incorrect to assume easements result in land being kept in an untouched natural state. While easements generally restrict extensive development of property, more than 70 percent allow some kind of residential construction (construction of an average of two new residential units is permitted).

Additionally, creating a conservation easement does not preclude transfer or division of the land in multiple parcels. For 22 percent of our sample, transfers of multiple parcels are allowed (an average of 2 parcels can be transferred).

Additional attributes showed some easements allow for sub-surface minerals exploration, and timber harvest or management is also allowed on some easement properties. These attributes indicate landowners will often continue to actively manage their land resources once an easement is created. Although easements can be amended through negotiation between grantor and grantee, the data shows this happens relatively infrequently. Only 7.5 percent of easement agreements we reviewed have been amended in some form. The final attribute we highlight in the table is public access to easement properties. Conservation easements are private

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transactions and only 3 percent of the easements in our sample allow for some kind of public access to the land. The majority of conservation easements do not allow for public access as part of the agreement and the landowner retains all their usual rights over access (with the exception being grantee access for monitoring purposes).

Most Easements Meet Public Benefit Standard, but Benefits are Unclear in Some Easement Provisions

In assessing the public benefit of easement provisions, grantors and grantees must strike a balance between permitted and restricted activities. Preventing all development may actually harm conservation values that would otherwise be protected through active stewardship. However, allowing too many activities or allowing activities that are inappropriate to a specific situation can also undermine the conservation purposes of the agreements.

The majority of easements we reviewed meet the public benefit standard and demonstrate that active management and limited development of land are not incompatible with open space preservation and environmental conservation. However, in some cases it was not clear the easement itself or specific provisions or terms in the agreement would necessarily meet the public benefit standard. The following discusses examples we identified during review of easement agreements.

- ▶ **Intrusive or Inconsistent Development/Construction** – we identified several examples of development permitted in easement agreements which could be considered intrusive or inconsistent with conservation purposes. Although the agreements generally provide for grantee approval for developments, it was not clear whether the following activities could be reconciled with conservation values:
 - Construction of ski runs and lifts at a private resort community
 - Development of a 5-acre sports field complex
 - Construction of a helicopter hangar and landing pad
- ▶ **Intensity of Residential Development** – we observed wide variations in intensity of residential development permitted in easements. In some cases, the number of permitted residential units and the number of transferable parcels were far above the

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prevailing norm. For example, one agreement allowed construction of up to 12 new residences and transfer of these residences on 12 separate parcels. In very large acreage easements these kinds of provisions may not be significant, but for smaller acreages there is a risk permitted residential development may conflict with the conservation purposes of the agreements.

- ▶ **Coincident or Adjacent Subdivision Development** – we documented examples of easements created coincident with properties with existing subdivision or in conjunction with new subdivision development. In one example of apparently coincident development, an easement was placed on a group of residential properties covering approximately 640 acres. Although the agreement prevents further development, the area is already relatively developed and it is unclear what conservation value the easement has, other than the protection offered to the privacy and seclusion of the existing home sites.

We also identified easements which were apparently negotiated in conjunction with ongoing subdivision development. In two documented examples, the easement properties are owned by corporations engaging in adjacent subdivision. Because the easement grantor and the developer of the subdivision are the same entity, the easement agreement potentially facilitates development by providing tax advantages to offset costs. These agreements may protect land that would otherwise be subdivided, but there may also be advantages to the property owner that diminish or negate the conservation purpose of the agreement.

- ▶ **Development Parcel/Envelope Size** – many easement agreements contain provisions defining the location and extent of envelopes of land where development can occur. In two documented examples, the size of the development parcels appeared to be disproportionate relative to the overall acreage of the easement. It is unclear how well conservation purposes can be served where easement grantors are given such wide latitude in determining development patterns.
- ▶ **Non-Qualifying Organization Agreements** – we identified one example of an easement agreement negotiated between two entities, neither of which was a qualifying organization as defined in federal and state law. In this example, the grantor was the property owner, but the grantee is a private company with no apparent standing as a qualifying organization. This agreement was properly recorded as a conservation easement agreement in county records, but because no qualifying organization is named

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as a party to the agreement, the easement cannot be assumed to have any conservation purpose.

Public Benefit and Easement Value

Additional audit work addressed the issue of changes in land values and how these relate to the donated value of easements. As discussed in Chapter V, we obtained data from the DOR showing market sales values for some easement properties. This analysis identified 12 different easement properties where sales events had occurred both before and after creation of the easement. The following table shows the sales data for these properties.

Table 10
Sales Price Data for Easement Properties

<u>Property</u>	<u>First Sale</u>		<u>Easement Year</u>	<u>Second Sale</u>		<u>Value Change</u>	<u>Annual % Change</u>
	<u>Year</u>	<u>Price</u>		<u>Year</u>	<u>Price</u>		
Example 1	1990	\$125,000	2000	2005	\$600,000	\$475,000	25%
Example 2	1991	\$108,000	1999	2002	\$155,000	\$47,000	4%
Example 3	1992	\$250,000	1997	2005	\$49,250	-\$200,750	-6%
Example 4	1992	\$122,000	1999	2000	\$172,000	\$50,000	5%
Example 5	1995	\$9,885	1997	2003	\$230,720	\$220,835	279%
Example 6	1996	\$15,000	2000	2002	\$122,000	\$107,000	119%
Example 7	1997	\$500,000	1999	2001	\$88,000	-\$412,000	-21%
Example 8	1999	\$385,000	2000	2005	\$390,000	\$5,000	0%
Example 9	1999	\$25,000	2000	2004	\$60,000	\$35,000	28%
Example 10	1999	\$600,000	2000	2005	\$1,611,769	\$1,011,769	28%
Example 11	1999	\$185,000	2001	2002	\$261,000	\$76,000	14%
Example 12	2000	\$830,000	2000	2005	\$1,150,000	\$320,000	8%

Source: Compiled by the Legislative Audit Division from Department of Revenue and Montana Natural Heritage Program records.

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This data demonstrates the complexity involved in accurately appraising easement properties. Although some of the listed properties dropped in value following easement creation, many saw substantial increases. We cannot determine why these increases or decreases occurred and they could be related to a variety of factors (residential development on previously vacant land, high demand in particular locations, or general market trends). For most of these examples, the appraised value of the easement would have been based on highest and best use (alternative uses for the land). Without reviewing the appraisals, it is not possible to determine whether the easement value was calculated correctly or what the potential tax benefits could be. In some of the examples, it is possible easement creation had no negative effect or even increased the value of the property. In this circumstance, it would be difficult to justify the donation of the easement as a charitable contribution, as the grantor would not have realized any financial loss.

Lack of Public Oversight Undermines Public Trust

It should be noted that our review of easement provisions and property values identified only a limited number of examples where there are concerns with the public benefit of the easements. Out of 120 agreements reviewed, we identified 10 where questions relating to public benefit were unresolved. Only two of these examples were identified as being potentially abusive in nature. Nevertheless, these examples do highlight concerns with the lack of oversight of easements in general. Although we cannot determine whether any of these grantors sought or received tax benefits, we are also unable to provide assurances these agreements were subject to any level of scrutiny by a competent public authority. Without assurances provided by some form of oversight, there is a growing danger of undermining the duty of public trust implicit in conservation easement agreements.

Conclusion: Conservation easements in Montana are generally being written and enforced for conservation purposes, but there is no effective public oversight ensuring the public trust is upheld in these transactions.

Chapter VII – Public Oversight of Conservation Easements

Improving Public Oversight of Conservation Easements

The issues we identified relating to specific easement provisions and easement property values indicate the public benefit tests outlined in federal and state law may not be upheld in all easement agreements. In cases where a grantor benefits financially through tax deductions, the failure to meet the public benefit standard could undermine the public trust. There is currently no assurance that easement agreements are subject to oversight by a competent public authority to determine public benefit. Easement agreements are submitted for county planning review, but comments are only advisory in nature. Most of Montana's non-governmental easement grantees are well-established and reputable organizations, but their easement transactions are governed by voluntary codes of conduct. Improving public oversight mechanisms for these transactions could strengthen accountability and public trust in conservation easements generally.

Options for Improving Oversight

Montana has always been a national leader in development of legal and procedural mechanisms relating to conservation easements. Unfortunately, this national leadership role means there are few other examples from other states of public oversight mechanisms for conservation easements. Audit work addressing existing public oversight mechanisms, input from interested parties, and information from other states allowed us to identify some potential means of improving oversight. The following provides a non-exhaustive and non-exclusive list of options for addressing this issue.

- ▶ **Agency reporting** – identifying a specific agency of state government to periodically compile and report information on easements. This reporting could involve cooperation of land trusts and other grantees and include review of specific easement agreements. Information could be reported to an interim committee of the legislature or released publicly through some other means.
- ▶ **Tax examination/audit** – the Department of Revenue could prioritize examination and audit efforts directed towards qualified conservation contributions claimed as deductions by Montana tax payers. By directing limited audit resources and publicizing the effort, the department could help tax payers better understand the legal standards relating to conservation easements.

Chapter VII – Public Oversight of Conservation Easements

- ▶ **Grantee certification** – revising statute to establish a certification mechanism for easement grantees could ensure that only certified organizations can negotiate easement agreements. Certification could involve establishing standards for grantees, such as adoption of Land Trust Alliance Standards and Practices (see above). A state agency, or potentially county clerk and recorders, would be responsible for ensuring all easement agreements are granted to certified organizations.
- ▶ **Specific statutory guidance** – Montana statute could be revised to provide more specific guidance relating to permitted and restricted activities. For example, statute could be amended to specifically define the density of residential development allowed on easement properties or the minimum contiguous acreage allowable as an easement.
- ▶ **Agency review and approval** – Montana could follow the example of the state of Massachusetts, which requires state agency approval for all conservation easements created by local governments or private land trusts. The Massachusetts Secretary of Environmental Affairs is responsible for reviewing and approving all easement transactions. This level of agency oversight would allow for a detailed review of provisions for easement proposals.

Any decisions regarding adoption of one or more of these oversight options would involve balancing the risk of undermining public trust in conservation easements against the potential for creating restrictive bureaucratic obstacles to their creation. The greatest strength of conservation easements lies in their ability to harness private resources to promote public purposes. However, the private nature of easement transactions inevitably comes into conflict with provision of public funding for their creation. Promoting accountability in the use of these public resources is important if conservation easements are to continue being recognized as providing real public benefits.

Public Oversight Decisions and the Legislature's Policy Role

Decisions regarding improved public oversight ultimately rest with the legislature as a matter of public policy. The current policy approach to easements has relied on voluntary oversight and self-policing by easement grantors. We believe changing circumstances mean this policy approach is no longer sufficient to ensure the public trust is upheld. In the 30 years since passage of original enabling

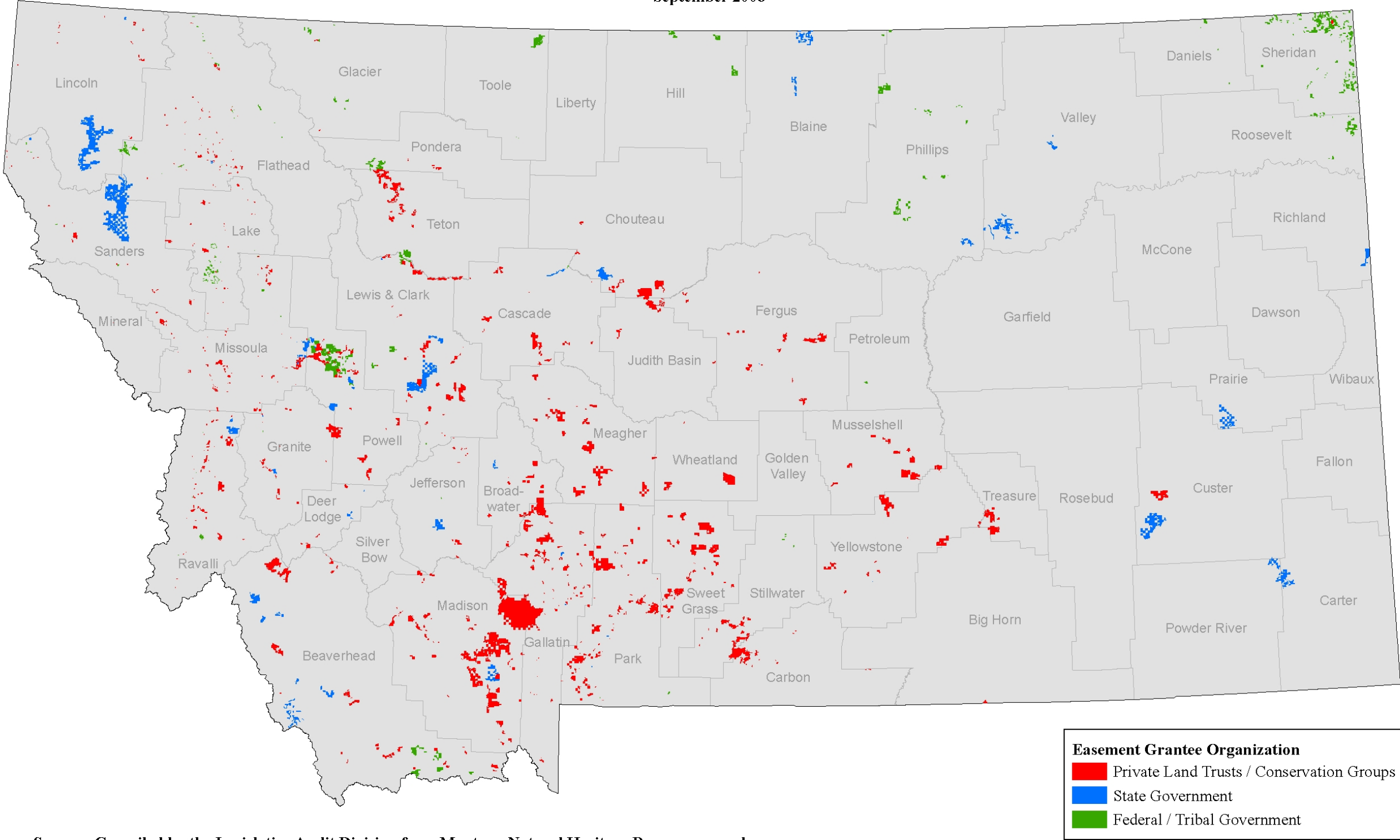
Chapter VII – Public Oversight of Conservation Easements

legislation, conservation easements have become an increasingly significant land use issue. Conservation easements are now a significant feature of many of Montana's traditional landscapes and cover an increasing proportion of private land in the state. The public benefits easements provide through open space preservation have been supported with over \$100 million in public funding. This level of public investment demands some degree of oversight to provide for accountability and ensure conservation easement agreements continue to provide public benefits.

Recommendation #3

We recommend legislation be enacted to ensure conservation easements are subject to public oversight.

Montana Conservation Easements by County and Grantee
September 2006



Source: Compiled by the Legislative Audit Division from Montana Natural Heritage Program records.

Appendix B – County Conservation Easement Data

<u>County</u>	<u>Conservation Easement Acres</u>	<u>% State Total Easement Acres</u>	<u>Total County Acres</u>	<u>% of County Land Mass</u>	<u>Average Easement Acreage</u>
Madison	204,037	12.97%	2,350,828	8.68%	1,594
Gallatin	99,063	6.30%	1,683,524	5.88%	1,001
Beaverhead	89,992	5.72%	3,565,674	2.52%	1,071
Powell	87,415	5.56%	1,491,190	5.86%	901
Lewis & Clark	86,801	5.52%	2,235,890	3.88%	1,258
Sanders	81,754	5.20%	1,783,658	4.58%	2,044
Park	77,913	4.95%	1,799,751	4.33%	721
Lincoln	62,644	3.98%	2,350,828	2.66%	1,740
Sheridan	57,925	3.68%	1,091,671	5.31%	616
Sweet Grass	57,778	3.67%	1,190,775	4.85%	1,204
Meagher	55,008	3.50%	1,530,906	3.59%	1,667
Teton	38,025	2.42%	1,465,710	2.59%	1,653
Custer	37,282	2.37%	2,425,137	1.54%	2,868
Chouteau	35,719	2.27%	2,555,542	1.40%	2,748
Ravalli	31,817	2.02%	1,534,711	2.07%	413
Missoula	29,556	1.88%	1,673,698	1.77%	253
Flathead	29,150	1.85%	3,361,798	0.87%	208
Yellowstone	26,783	1.70%	568,968	4.71%	1,488
Musselshell	26,501	1.68%	1,196,012	2.22%	2,208
Cascade	24,963	1.59%	1,733,386	1.44%	675
Phillips	24,539	1.56%	3,333,350	0.74%	1,022
Fergus	23,182	1.47%	2,780,933	0.83%	966
Valley	21,855	1.39%	3,237,540	0.68%	911
Stillwater	21,795	1.39%	1,154,183	1.89%	948
Wheatland	20,599	1.31%	913,056	2.26%	5,150
Broadwater	19,843	1.26%	792,072	2.51%	1,417
Carbon	17,544	1.12%	1,319,462	1.33%	877
Granite	16,972	1.08%	1,107,971	1.53%	499
Treasure	16,137	1.03%	629,181	2.56%	2,017
Blaine	15,577	0.99%	2,711,308	0.57%	1,298
Lake	15,424	0.98%	1,057,225	1.46%	237
Prairie	13,953	0.89%	1,113,873	1.25%	872
Judith Basin	12,914	0.82%	1,195,790	1.08%	2,152
Jefferson	12,153	0.77%	1,060,617	1.15%	506
Carter	10,882	0.69%	2,141,781	0.51%	1,360
Pondera	10,097	0.64%	1,048,688	0.96%	1,122
Roosevelt	9,787	0.62%	1,515,444	0.65%	612
Hill	9,762	0.62%	1,865,477	0.52%	2,440
Toole	9,295	0.59%	1,244,848	0.75%	3,098
Powder River	6,767	0.43%	2,109,764	0.32%	3,384
Richland	5,992	0.38%	1,344,527	0.45%	2,996
Deer Lodge	5,222	0.33%	473,881	1.10%	475
Glacier	4,907	0.31%	1,942,998	0.25%	377
Big Horn	3,466	0.22%	3,207,937	0.11%	1,733
Daniels	2,055	0.13%	912,715	0.23%	514

Appendix B – County Conservation Easement Data

<u>County</u>	<u>Conservation Easement Acres</u>	<u>% State Total Easement Acres</u>	<u>Total County Acres</u>	<u>% of County Land Mass</u>	<u>Average Easement Acreage</u>
Silver Bow	1,949	0.12%	1,091,671	0.18%	21
Petroleum	570	0.04%	1,070,050	0.05%	570
Mineral	47	0.00%	781,984	0.01%	47
Liberty	0	0.00%	925,755	0.00%	0
Golden Valley	0	0.00%	752,063	0.00%	0
Rosebud	0	0.00%	3,213,997	0.00%	0
Garfield	0	0.00%	3,098,685	0.00%	0
McCone	0	0.00%	1,715,096	0.00%	0
Dawson	0	0.00%	1,523,385	0.00%	0
Wibaux	0	0.00%	568,968	0.00%	0
Fallon	0	0.00%	1,037,600	0.00%	0
Totals	1,573,411	--	93,583,532	1.68%	--

Appendix C – Land Cover Data for Conservation Easements

<u>Vegetation Class</u>	<u>Acreage</u>	<u>% of Total</u>	<u>Vegetation Sub-Class</u>	<u>Acreage</u>
Forest	721,202	46%	Western Woodlands	236,850
			Western Pine Forest	162,844
			Western Conifer	134,979
			Rocky Mtn Mixed Forest	91,273
			Sub-alpine Forest	54,768
			Western Mixed Forest	15,341
			Coniferous Forest	9,429
			Western Deciduous	6,372
			Conifer/Mixed Forest	3,689
			Woodland/Pasture	2,463
			Coniferous Woodlands	1,653
			Northwest Forest	648
			Mixed Forest/Crop	441
			Mixed Hardwoods	384
			Mixed Forest	69
Croplands	238,038	15%	Cropland/Grassland	114,844
			Cropland/Woodland	70,435
			Cropland	52,260
			Cropland/Forest	498
Grasslands	538,815	34%	Grassland	503,464
			Grassland/Cropland	33,527
			Grassland/Pasture	678
			Grass/Shrubs/Woodland	437
			Grassland/Woodland	382
			Savanna	327
Shrublands	68,063	4%	Desert Shrubs/Grass	66,928
			Desert Shrubs	1,136

Appendix D – Audit Scope and Methodologies

Audit Scope

Audit scope was based primarily on the guidance contained in Senate Joint Resolution (SJR) 20. SJR 20 provided direct guidance in formulating our first three audit objectives. Audit scope was expanded to include other issues relating to conservation easements, which are addressed under our final two audit objectives. The decision to expand audit scope to cover these additional objectives was based on audit planning work

Included within the scope of the audit were all conservation easements developed in Montana since approximately 1975. Timeframes for specific types of analysis varied depending on the availability of data, but generally covered at least the period between 1995 and 2005. Information contained in the statewide conservation easement inventory referenced in this report should be considered current through September 2006.

Audit scope focused on the activities of state agencies with involvement in either creating easements or compiling data relating to some aspect of easement creation. These agencies included the Department of Revenue, the Department of Administration, the Department of Fish, Wildlife and Parks, and the Montana Natural Heritage Program.

Scope Exclusions

Specifically excluded from audit scope were attempts to conduct large-scale cost-benefit analysis of easement impacts in local governments. This would include an approach known as Cost of Community Services and also types of analysis addressing opportunity costs associated with restrictions on residential developments. These modes of analysis involve high levels of technical expertise or significant resources not available to the audit function.

Audit Methodologies

Audit methodologies were developed to assist in audit planning and to address audit objectives. Methodologies are discussed in the sections following.

Appendix D – Audit Scope and Methodologies

Audit Planning

Audit planning work included collection and review of various federal and state statutes, regulations and rules relating to conservation easements. We also reviewed recent Montana legislative actions relating to easements, including bills introduced in the 2005 Legislative Session. Staff in state agencies with involvement in conservation easement issues were interviewed and we obtained information relating to specific agency programs and operations. We conducted initial review of easement data compiled by the Montana Natural Heritage Program (MNHP) and the Department of Fish, Wildlife and Parks (FWP) to determine what level of existing information was available. We contacted officials in county governments to obtain input regarding local government procedures addressing recordation of easements and to review examples of easement agreements. We also discussed audit planning and potential objectives with representatives of land trusts and conservation groups acting as easement grantees, and with representatives of groups opposed to conservation easement creation.

Statewide Conservation Easement Inventory

Compiling and analyzing the statewide conservation easement inventory involved several inter-related methodologies. Initially, easement data contained in the MNHP land stewardship data layer was identified using Geographic Information Systems (GIS) software applications. This easement data was used to identify a list of active easement grantees and these agencies or organizations were contacted to obtain confirmation of their current easement holdings. In conjunction with this review, we selected 10 counties for inclusion in methodologies involving review of easement agreements. Counties were selected in descending order based on total acreage of easements held by non-governmental grantees. We randomly selected a judgmental sample of 15 percent of easement agreements for each county, for a total of 120 sample items. County land records were accessed to test for easement attributes contained in the MNHP data. These attributes included existence, location, acreage and grantor/grantee status. We also used this review methodology to collect additional attributes not included in the MNHP data.

Results of attribute testing conducted in counties were used to establish the level of accuracy in the MNHP data sets. Easement data supplied by grantees was also used to comparatively assess the attributes of the MNHP data. MNHP data was then used as the basis for compiling a statewide conservation easement inventory, which also incorporated updated easement data for 2006 and information supplied directly by grantees. The statewide inventory was used to extract and analyze additional attributes with GIS applications. These data extraction and analysis methodologies provided the basis of the information presented relating to the extent, locations and characteristics of conservation easements.

Conservation Easement Trends

MNHP data attributes were used to analyze trends in conservation easement creation. MNHP data was supplemented with grantee data to provide greater accuracy in date fields. Modes of trend analysis were identified by reference to attributes included in our statewide easement inventory. Trends in easement creation in Montana were compared against sources of data from other states in the Rocky Mountain west and nationally. Data from western states was sourced from COMaP program at Colorado State University and information included in the Colorado College 2006 State of the Rockies Report. National level data for easement holdings for members of the Land Trust Alliance was sourced from surveys conducted by the group in 2003 and 2005.

Easement Data Compilation and Reporting

All of Montana's county clerk and recorders were initially surveyed through the Department of Revenue to determine awareness of and compliance with state law relating to easement recordation. We also conducted observations of land records in 10 counties (see reference above relating to easement inventory), and interviewed clerk and recorders or their staff. Observations and interviews focused on procedures used to record conservation easements and methods used to compile and report information on easements. Evaluation of data compilation and reporting by state agencies involved interviews with officials and review of records in the Department of Revenue, Department of Administration, and the Montana Natural Heritage Program. At the state level, we also assessed existing mechanisms

Appendix D – Audit Scope and Methodologies

for compiling land use information through the Cadastral system. Montana's procedures were also compared against land use data programs in other states or nationally (these programs included the national Gap Analysis programs, Colorado State University's COMaP program, and the Maine State Planning Office).

Property Taxes and Land Values

Assessment of conservation easement impacts on property taxes involved obtaining property tax classification and taxable value data for approximately 2,185 property parcels subject to easement. Tax data was sourced from the department's Computer Assisted Mass Appraisal (CAMA) system for the two most recent property tax reappraisal cycles in 1997 and 2003. Data for easement properties was analyzed to determine whether changes in tax classification had occurred between reappraisal cycles. We also analyzed department data for tax classification and value data for all state properties in 1999 and 2004. Statewide data was compared against easement properties to determine if significant trends or disparities were evident. DOR data was also used to identify easement properties where sales data was available via a Realty Transfer Certificate. Available sales data for easement properties was analyzed to identify examples of multiple sales events for specific easement property parcels.

Additional analysis of property tax implications addressed fiscal impacts on local governments resulting from open space preservation. We obtained and reviewed information from the American Farmland Trust and other organizations relating to Cost of Community Services (COCS) studies. We also reviewed academic and other studies addressing quantitative and methodological analysis of the COCS approach.

Direct and Indirect Public Funding

Public funding for conservation easement creation addressed both direct and indirect funding mechanisms. Direct funding was analyzed by collecting information from state and county governments involved in easement acquisitions. Data for easement acquisitions by the Department of Fish, Wildlife and Parks (FWP) was obtained from the Legislative Audit Division's 2005 financial

compliance audit of the department. We also obtained and reviewed data from the FWP 2005 Landbook. Information on county government open space bonding programs was obtained to determine the level of funding available in three counties (Gallatin, Missoula, and Ravalli) through these programs.

Indirect public funding for easement creation is provided through federal and state income tax deductions. We contacted various officials in the federal Internal Revenue Service to discuss ongoing audit/examination programs addressing conservation easements. We also collected and reviewed studies and analysis conducted by other states addressing tax deductibility for easements. To determine the value of deductions claimed against Montana individual and corporate income taxes, we accessed Department of Revenue records for selected individuals and corporations believed to have created conservation easements in the 2003 and 2004 tax years. We reviewed Montana tax returns for these individuals/corporations to identify adjusted gross income levels and easement values associated with tax deductions. We used this information to estimate the value of these deductions over a ten-year period between 1995 and 2005 based on trends in income, land values and number of easements created by Montana residents. We also collected data from four states (Colorado, Connecticut, South Carolina and New Mexico) providing state tax credits for easement creation. Data from other states was also used to estimate the value of tax deductibility of easements in Montana.

Public Oversight of Conservation Easements

Methodologies addressing public oversight of conservation easements involved direct observation of easement properties, review and observation of land trusts monitoring procedures and practices, and evaluation of provisions contained in specific easement agreements. Observations of easement properties were conducted in conjunction with review of county land records (discussed above). We conducted observations on 30 different properties and documented the condition and uses of the land. Information from the Land Trust Alliance (LTA) relating to standards and practices for creating and managing conservation

Appendix D – Audit Scope and Methodologies

easements were reviewed. Monitoring visits conducted by the staff of two easement grantees (Montana Land Reliance and The Nature Conservancy) were also observed.

Attribute data was collected from approximately 120 conservation easement agreements we reviewed in county land records (see above). Attributes included the types of permitted and restricted activities, agreement amendments and public access provisions. Permitted and restricted activities were evaluated to determine whether they met public benefit guidelines contained in federal law. Information from various sources was collected which identified different types of oversight mechanisms for conservation easements. Sources included discussions with easement grantees, mechanisms used in other states, and academic or other studies addressing public oversight of easements.

Department Response

DEPARTMENT OF ADMINISTRATION
DIRECTOR'S OFFICE



BRIAN SCHWEITZER, GOVERNOR

JANET R. KELLY, DIRECTOR

STATE OF MONTANA

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PO BOX 200101
HELENA, MONTANA 59620-0101

January 11, 2007

Angie Grove
Deputy Legislative Auditor
Legislative Audit Division
PO Box 201705
Helena, MT 59620-1705

Dear Ms. Grove:

The Montana Department of Administration (DOA) has reviewed the recommendations contained in the January 2007 *Conservation Easement Performance Audit Report #06P-01*. I believe only recommendation #2 pertains to DOA. Our response appears below:

Recommendation #2

We recommend the Department of Administration develop procedures to allow for the integration of conservation easement data in the Cadastral system.

Response:

We concur. The Department of Administration will work with the Department of Revenue and the Montana Natural Heritage Program to develop procedures to incorporate conservation easement data into the Montana Cadastral Framework Database.

Enclosed is our Corrective Action Plan.

Sincerely,

A handwritten signature in cursive script, appearing to read "Janet R. Kelly".

Janet R. Kelly, Director

Enclosure

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JAN 11 2007

LEGISLATIVE AUDIT DIV.

CC: Dick Clark, CIO, ITSD
Stu Kirkpatrick, GIS Services Bureau Chief, ITSD
Mike Wingard, Auditor, Legislative Audit Division
Angus Maciver, Auditor, Legislative Audit Division
Randy Wilke, Department of Revenue
Sue Crispen, Montana Natural Heritage Program

Corrective Action Plan: Audit Report #06P-01
Performance Audit of Conservation Easements
Department of Administration
January 11, 2007

Agency	Recommendation #	Does this affect a federal program?	CFDA # (if previous YES)	Management View	CAP – Corrective Action Plan	Person responsible for CAP	Target Date
61010	Recommendation #2: We recommend the Department of Administration develop procedures to allow for the integration of conservation easement data in the Cadastral system.	No		Concur	<p>1) Obtain the most recent Stewardship Database from the Natural Heritage Program (NHP). Vertically integrate (align) the entire database with the cadastral database. Separate the existing conservation easements into a separate feature class. This action will insure that all existing conservation easements are on the same map base with the cadastral tax parcels and are synchronized with the Bureau of Land Managements Geographic Coordinate Database (GCDB). Revise conservation easement feature class metadata.</p> <p>2) Work with the Department of Revenue (DOR) to develop documented procedures for transfer of new conservation easements from the county Clerk and Records, through DOR, to D of A.</p> <p>3) Implement procedures to enter new conservation easement data into the Cadastral Database</p> <p>4) Publish conservation easement data through the present Cadastral Website</p> <p>5) Link conservation easement data with any pertinent fields in the DOR Computer Assisted Mass Appraisal (CAMA) database if DOR adds those fields to CAMA</p>	<p>Stu Kirkpatrick</p> <p>Stu Kirkpatrick</p> <p>Stu Kirkpatrick</p> <p>Stu Kirkpatrick</p> <p>Stu Kirkpatrick</p>	<p>1) 7/01/07</p> <p>2) 7/01/07 (Dependent on DOR's concurrence with audit)</p> <p>3) 9/30/07</p> <p>4) 10/30/07</p> <p>5) Dependent on DOR actions</p>



Dan Bucks
Director

Montana Department of Revenue



Brian Schweitzer
Governor

January 12, 2007

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JAN 15 2007

LEGISLATIVE AUDIT DIV.

Mr. Scott Seacat, Legislative Auditor
Legislative Audit Division
Room 160, State Capitol
P. O. Box 201705
Helena, MT 59620-1705

Re: Performance Audit of Conservation Easements

Dear Mr. Seacat:

The Department of Revenue responses to the audit recommendations and conclusions are as follows.

RECOMMENDATION #1

We recommend the Department of Revenue ensures county-level conservation easement data is compiled consistently by:

- A. Providing guidance and direction on easement data collection to county clerk and recorders through local department staff; and**
- B . Updating CAMA to include conservation easement attribute fields.**

Partially Concur with Recommendation 1A: The current law requirements for Clerk and Recorders and the Department of Revenue in the area of conservation easements is straightforward. The law does not indicate that the Department of Revenue should guide or direct locally elected Clerk and Recorders on how they should collect, record, compile and forward conservation easement information to the Department of Revenue. Department of Revenue staff has been instructed to work with their local Clerk and Recorder in order to ensure that copies of conservation easements are provided to the Department of Revenue. Department of Revenue staff has been instructed to maintain files containing conservation easements. Clerk and Recorders have not requested any additional information pertaining to this statute. The Department of Revenue does not have the authority to guide or direct county Clerk and Recorders. If the legislature wants the Department of Revenue to have authority to direct Clerk and Recorders in the

area of conservation easement collection, recordation, and compilation, the legislature should expressly provide that authority. The Department of Revenue is quite willing to make regular requests of Clerk and Records for conservation easement information through its local staff.

Concur with Recommendation 1B: The Department of Revenue has updated its legacy computer assisted mass appraisal system (CAMAS) to include conservation easement attribute fields for those conservation easements it has been provided. The Department of Revenue acquired the geographic information system (GIS) information on conservation easements from the Montana Natural Heritage Program. That information was matched with the department's cadastral information to identify those parcels in the Natural Heritage Program database. The Department of Revenue identified a user defined field in the CAMAS database and placed the descriptive code, CE, to identify each parcel that has a conservation easement.

In addition, the new Property Valuation and Assessment System (PVAS) will have specific field locations and drop down boxes that will identify conservation easements and the specific conserving agency.

The Department of Revenue welcomes the opportunity to address some of the audit conclusions with the intent of helping the Legislative Auditor make the audit report as accurate as possible:

Conclusion on page 15 (second paragraph) - The audit indicates that, "The majority of property covered by conservation easements is classified as agricultural for tax purposes."

Comment: Real property falls into three property tax classes: Class 3 -agricultural, Class 4 - residential/commercial and Class 10 – forestland. The data in Table 6 indicates that there is more Class 10 – forestland taxable value on properties with conservation easements than Class 3 – agricultural taxable value. Due to the large difference in tax class rates that are applied to these two property types, property, in terms of both taxable value of property and number of acres with conservation easements, is dominated by land classified as commercial forestland. Possibly, the sentence referenced on page 15 of the audit should be adjusted to reflect that the majority of property, in terms of taxable value and acreage, covered by conservation easements is classified as forest land for tax purposes. Also, consideration should be given to adjusting figure 2 to reflect that both agricultural land and forest land make up the vast majority of the tax classification for conservation easement properties.

Conclusion on page 17 (third paragraph) - Audit language says, "Easements are created primarily on private property usually classified as agricultural."

Comment: This statement should also include forestland, and non-qualified agricultural land. Small, local nonprofits are increasingly focusing on smaller properties that are found in the Class 3, non-qualified agricultural classification (20 to 160 acres in size). The statement might say, "Easements are created primarily on private property usually classified as agricultural, forest land, or nonqualified agricultural land."

Conclusion on page 28 (last paragraph) - The audit indicates that , "Statute assigns responsibility for collecting information relating to conservation easements to DOR...As the state agency assigned as the collection venue for this data, DOR bears responsibility for ensuring local governments follow standard procedures."

Comment: While the statute may assign responsibility for collecting information relating to conservation easements to DOR, there is no statutory authority for the DOR to tell local elected clerk and recorders how they should collect, record, compile and forward easement information to the DOR, or to require local governments to follow standard procedures in this area that have been developed by the Department of Revenue. As previously stated, DOR staff have been instructed and trained to work with their local Clerk and Recorder to help ensure that copies of conservation easements are transferred to the DOR. Unfortunately there is no requirement under current law that requires a filer notify local Department staff that a conservation easement has been recorded. Without that type of requirement the Department will not be aware that it should be looking for a copy of a conservation easement from the Clerk and Recorder.

Conclusion on page 29 (first paragraph) - The audit advises that even in situations where counties were reporting easement data to DOR, local staff had received no instruction on what to do with the information. Agreements were generally reviewed to ensure provisions did not affect agricultural tax classifications, but no further actions were taken.

Comment: The statute is unclear regarding what the DOR is supposed to do with this information. The statute states that local Clerk and Recorders must provide the DOR with a copy of the conservation easement. The DOR's primary concern has been the impact the easement would have on the property's land classification and assessment. DOR staff has been instructed to send conservation easements to the Forest and Agricultural Management Analyst in Helena if they believe that the easement might have an impact on the assessment of the property. The correct assessment and classification of conservation easement properties has been addressed in DOR training courses and in the DOR forestland and agricultural assessment manuals. Local DOR staff has been instructed to maintain files containing conservation easements and restrictive land covenants for future reference. Until recently, there has been no concerns registered with respect to the manner in which Department staff have

compiled the information. It would be helpful if the audit language would reflect the fact that local staff has received instructions on what to do with the information.

Conclusion on page 29 (fourth paragraph) - DOR should also develop procedures to ensure conservation easement attribute data is collected and maintained in statewide management information systems.... Updating CAMA to include fields for conservation easement attributes would allow DOR to maintain statewide data in a consistent manner for all new conservation easements.

Comment: The audit language references the collection and maintenance of conservation easement attribute data in statewide management information systems. It could become problematic for the department to specify how data is collected and maintained in another agency's statewide management system. If the reference to a statewide management system is the Department's CAMA system, then the Department believes it has previously addressed the concerns in the audit. As previously identified in the response to recommendation 1B, The Department of Revenue has updated its legacy computer assisted mass appraisal system (CAMAS) to include conservation easement attribute fields for those conservation easements it has been provided. The Department of Revenue acquired the geographic information system (GIS) information on conservation easements from the Montana Natural Heritage Program. That information was matched with the department's cadastral information to identify those parcels in the Natural Heritage Program database. The Department of Revenue identified a user defined field in the CAMAS database and placed the descriptive code, CE, to identify each parcel that has a conservation easement.

In addition, the new Property Valuation and Assessment System (PVAS) will have specific field locations and drop down boxes that will identify conservation easements and the specific conserving agency.

Since the information has been previously identified and given a unique descriptive code, it would be helpful to indicate that, "The DOR has developed procedures to ensure conservation easement attribute data is collected and maintained in its statewide CAMA management system. The Department's CAMA system includes attribute fields for conservation easements. That allows the Department to maintain statewide data in a consistent manner for all new conservation easements. In addition, those conservation easements that are currently known to the Department have been identified using those fields.

Conclusion on page 31 (first paragraph) - DOR is the only state agency referenced in statute relating to compilation and reporting of conservation data.

Comment: Current law states that local Clerk and Recorders must provide the DOR with a copy of the conservation easement. The statute doesn't appear to reference the compilation and reporting of the conservation easement data. In fact in paragraph 3 on

page 31 of the audit, it states, "*Statute does not clearly assign a role to any specific state agency relating to the reporting of conservation easement data.*" Possibly the conclusion on page 31 could be rephrased to say, "While the DOR is the only state agency referenced in statute relating to conservation data, there is no clearly assigned statutory role for any state agency relating to compilation and reporting of conservation data."

Conclusion on page 31 (third paragraph) - DOR has not been actively maintaining information relating to easements through the Property Tax Assessment Division or the CAMA system.

Comment: The DOR used the Montana Natural Heritage Program data to identify parcels in the state's cadastral database that have conservation easements. In addition, the DOR created a user defined field in CAMAS for conservation easements, and has been maintaining the identification of land with conservation easements in the CAMAS for those properties it is aware of that have conservation easements.

Conclusion on page 40 (paragraph one) - As shown, there are significant differences between the proportions of and trends in taxable value for the three property classes when conservation easements are compared against statewide totals.

Comment: The audit reference pertains to Table 6 that reflects Trends in Taxable Values for Montana Properties and Easement Properties. There are several factors that influence the data presented in Table 6.

- Montana reappraises all real property once every six years. Real property is not adjusted up or down during this timeframe due to market forces.
- The legislature has chosen in previous reappraisal cycles to make the statewide reappraisal valuation changes taxable value neutral. However, for Class 4 property, the legislature has allowed the increase in taxable value from new construction to be included in the new Class 4 tax base. For Class 3 property, the Department has not conducted any statewide reclassification. For example, there are instances where higher valued farmland is classified as lower valued grazing land. That will not be corrected until the DOR completes reappraisal and the new values are used for tax purposes in 2009. For Class 10 property, a change in the landowner's forestland productivity grades would impact the assessed value and thus, the Class 10 tax base. However, changes in forestland productivity grades are extremely rare.
- Individual property assessments can be adjusted during a reappraisal cycle due to two factors - new construction and

destruction. New construction may be the addition of new buildings or land use changes in Class 4, changes to productivity grades or agricultural use changes in Class 3 and productivity changes in Class 10 property. Destruction is the loss of physical structures in Class 4 or natural disasters that destroy commercial timber in Class 10. Destruction cannot occur to Class 3 property (agricultural land cannot be destroyed). Conversion to other uses as discussed above, have resulted in taxable value reductions to Class 3 and Class 10 properties.

- Column One in Table 6 reflects the Taxable Value trends for the past 6 years. Class 3 Agricultural Land shows a 0.5% increase. This minor increase is due to the fact the Legislature has made the reappraisal valuation of this property type taxable value neutral. Additionally, assessment changes due to changes in agricultural use or productivity will not occur until the current reappraisal cycle has been completed on December 31, 2008. Class 4 residential/commercial property shows a 20 percent increase. The legislature has mitigated the statewide reappraisal increases, but new construction has increased the tax base (new construction overshadows destruction of buildings). Class 10 forestlands shows a 20 percent decrease in taxable value. As with Class 4 property, the legislature has mitigated any valuation increases, but destruction of standing timber attributed primarily to forest fires has decreased the statewide tax base.
- Column Two in Table 6 reflects the Taxable Value Trends of individual properties that contain a conservation easement. Describing taxable value trends in this category is difficult to explain without examining specific factors impacting each property in this subset. It would be highly unusual for the 6-year trend in column one to match the 6-year trend figures in column two. All three property classes show an increase in taxable value. The legislature has adopted mitigation measures each reappraisal that have resulted in statewide taxable neutrality for those classes of property. However, individual properties may go up or down. It would appear that properties containing conservation easements have generally seen larger than average market increases (even agricultural and forest land valuations use agricultural commodities and stumpage values). Additionally, it would appear that Class 10 properties with conservation easements have largely escaped natural disaster losses or they have not been reported to the DOR.

Over the past several years, agricultural and forest land acres have been converted to residential and commercial uses. While that has resulted in a loss of taxable value for Class 3 and Class 10

property, it has resulted in an increase in taxable value for Class 4 property. With that understanding, the table shows that properties containing conservation easements seem to have experienced less land use changes. Otherwise, the 6-year taxable value trend associated with conservation easements would have been significantly less when compared to the statewide taxable value trend.

Conclusion on page 40 (second paragraph) - Because conservation easements restrict the ability to have significant changes in land use, it should not be surprising that changes in tax valuations for easement properties do not correspond with prevailing state trends.

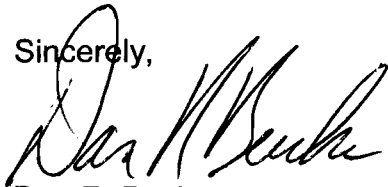
Comment: Conservation easements have virtually no impact on the figures shown in Table 6. The trends shown in Table 6 are due primarily to decisions made by the legislature regarding the classification and assessment of real property as described above.

Conclusions on page 41 (second paragraph) - These circumstances indicate the creation of conservation easements does have the potential to result in shifts in property tax collections for local governments over the long term.

Comment: Conservation easements typically prevent most development from occurring on property that is classified and assessed as agricultural or forestland. Conservation easements are intended to maintain the current land use and thus the current property tax status. Development changes the land use and thus the current tax status. To the contrary of the audit statement, conservation easements tend to maintain the status quo and do not typically result in measurable shifts in property tax collections.

We appreciate, as always, the courtesy and professionalism of the legislative audit staff – qualities they brought to bear in conducting this audit.

Sincerely,

A handwritten signature in black ink, appearing to read "Dan R. Bucks", written in a cursive style.

Dan R. Bucks
Director